

87-616
No.

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Supreme Court, U.S.

FILED

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In the Supreme Court of the United States

OCTOBER TERM, 1987

HUBERT PARK BECK, DOROTHY FAHS BECK,
ROBERT J. BECK and OTTO WEINMANN,
Petitioners,

vs.

MANUFACTURERS HANOVER TRUST COMPANY;
MILBANK, TWEED, HADLEY & McCLOY;
KELLEY DRYE & WARREN; DONALD B. HERTERICH;
ISAAC SHAPIRO; and EDWARD ROBERTS, III,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

STUART HECKER, ESQ.
Attorney for Petitioners
521 Fifth Avenue
New York, New York 10175
(212) 682-7070



QUESTION PRESENTED

Whether, after holding that the defendants had engaged in a "pattern of racketeering activity" under the RICO statute, the Second Circuit was correct in affirming the dismissal of plaintiffs' amended complaint on the ground that the defendants' association-in-fact, which performed all of the predicate acts constituting the "pattern," lacked sufficient continuity to constitute an "enterprise" under RICO.

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SHAPIRO; and EDWARD ROBERTS, III,

Respondents.

**PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT**

Petitioners respectfully pray that a writ of certiorari issue to review the order of the United States Court of Appeals for the Second Circuit, entered on July 14, 1987, which on petition for rehearing affirmed a judgment of the United States District Court for the Southern District of New York dismissing petitioners' amended complaint,

brought under the Racketeer Influenced and Corrupt Organizations Act ("RICO").

OPINIONS BELOW

The opinion of the District Court, holding that plaintiffs had not adequately pled "racketeering activity" or a "pattern of racketeering activity" under RICO, is reported at 645 F. Supp. 675 (S.D.N.Y. 1986), and is reproduced as Appendix A. The opinion of the District Court on reargument, affirming its original decision, is reported at 650 F. Supp. 48 (S.D.N.Y. 1986) and reproduced as Appendix C. The opinion of the Court of Appeals, reversing the District Court on both the issues of "racketeering activity" and "pattern," but affirming its judgment on the ground that plaintiffs had not adequately pled a RICO "enterprise," is reported at 820 F. 2d 46 (2d Cir. 1987) and reproduced as Appendix D.

JURISDICTION OF THIS COURT

On June 1, 1987 the Clerk of the Circuit Court entered an order affirming the judgment of the District Court dismissing the amended complaint. On July 14, 1987 she entered an order denying plaintiffs' petition for rehearing, which contained a suggestion that the appeal be reheard *en banc*. These orders are reproduced, respectively, as Appendix E and Appendix F. This petition is filed pursuant to 28 U.S.C. §1254(1), within the time permitted by 28 U.S.C. §2101(c) and Rule 29.1 of this Court.

STATUTES

The statutes involved are U.S.C. §§1961 and 1962, the first two sections of RICO. They are reproduced as Appendix G.

STATEMENT OF THE CASE

This action was instituted in the United States District Court for the Southern District of New York under RICO, 18 U.S.C. § 1961 *et seq.* Plaintiffs are holders of two series of bonds that were issued by National Railroad Company of Mexico in 1902, and secured by collateral held in an indenture trust by defendant Manufacturers Hanover Trust Company ("Manufacturers") as trustee. Defendant Kelley Drye & Warren ("Kelley") was counsel to Manufacturers as trustee during the period relevant to this action; defendant Milbank, Tweed, Hadley & McCloy ("Milbank") was and is counsel to the United States of Mexico ("Mexico"), recognized by Manufacturers as the holder of more than ninety percent of the face amount of each series of the bonds.

The individual defendants are the representatives of Manufacturers, Kelley, and Milbank who were charged with primary responsibility for matters growing out of the administration of the indenture trust.

Plaintiffs' amended complaint alleges that the defendants defrauded plaintiffs, other individual bondholders, and Mexico of a vast fortune in three phases of unlawful activity relating to the administration of the indenture trust. The RICO predicate acts alleged involve violations of 18 U.S.C. §1341 (relating to mail fraud), and 18 U.S.C. §1343 (relating to wire fraud). The phases of unlawful activity alleged included the following:

(i) Phase I: the defrauding of plaintiffs and similarly situated holders of Prior Lien Bonds by unlawfully treating Mexico as a holder of those bonds with respect to seven distributions of accrued interest from April 1, 1972 through December 31, 1981. Through this treatment defendants wrongfully permitted more than ninety percent of each such distribution to be siphoned off to Mexico, to the detriment of plaintiffs and other individual holders of Prior Lien Bonds.

(ii) Phase II: the defrauding of plaintiffs and similarly situated holders of both series of bonds of substantially the entire value of the collateral held by Manufacturers as indenture trustee through (a) the sale of the collateral at a fraudulently low price, and (b) the treatment of Mexico as a bondholder entitled to 95.83% of the fraudulently low proceeds of the sale.

(iii) Phase III: the defrauding of the government and people of Mexico of their purported share of the proceeds of the sale of the collateral through (a) the sale of the collateral at a fraudulently low price; (b) the failure to disclose to the government of Mexico that it was being defrauded by corrupt Mexican nationals, some of whom were government officials, and that Mexico could have appeared at the sale and purchased the collateral for little or no cash outlay; and (c) the acceptance from the purchaser by Manufacturers, in payment of 95.83% of the sale price, of a fraudulent and legally ineffective assignment, given without consideration, of Prior Lien Bonds previously recognized by Manufacturers as validly held by Mexico.

Phase I spanned 9-1/2 years. Phase II, from its planning in the 1970's to its conclusion at the closing of the sale of collateral, on November 29, 1982, spanned at least three years. Phase III, which began sometime during 1982 and

ended with the sale of collateral, lasted at least several months.

The District Court Decision

Defendants moved to dismiss the amended complaint (i) pursuant to Fed. R. Civ. P. 12(b)(6) for failure, on numerous grounds, to state a claim under RICO; (ii) pursuant to Fed. R. Civ. P. 9(b) for failure to plead fraud with particularity; and (iii) because the action was barred by the applicable statute of limitations. The motion also demanded costs and attorneys' fees under Fed. R. Civ. P. 11 and 28 U.S.C. §1927.

The District Court held that the action was timely instituted, 645 F. Supp. at 679, and that defendants were not entitled to sanctions. *Id.* at 685. However, it dismissed the amended complaint on the alternative grounds that plaintiffs had not adequately pled racketeering activity, *Id.* at 680-83, or a pattern of racketeering activity, *Id.* at 683-85, as required by RICO.

With respect to the issue of racketeering activity the District Court held that the misrepresentations alleged in Phase I were "immaterial as a matter of law," *Id.* at 681, and that while the allegations of Phases II and III satisfied both Rule 12(b)(6) and the "particularity" requirement of the first part Rule 9(b), those allegations did not satisfy, with respect to scienter, the second requirement of Rule 9(b)—that "malice, intent, knowledge, and other condition of mind ... may be alleged generally." *Id.* at 682-83.

Plaintiffs subsequently moved the District Court for reargument and reversal of its decision. The District Court granted the motion for reargument, but affirmed its

prior opinion in all respects. 650 F. Supp. 48 (S.D.N.Y. 1986). —

The Circuit Court Decision

On the issue of racketeering activity the Second Circuit affirmed the holding of the District Court with respect to Phase I, but reversed as to Phases II and III. 820 F. 2d at 50.

On the issue of "pattern" the Second Circuit reversed the District Court, holding that while Phases II and III constituted, in the aggregate, a single episode of racketeering activity, the Second Circuit rule is that two related predicate acts constituting a single such episode are sufficient to establish a "pattern" under RICO. *Id.* at 51.

If the Second Circuit had stopped at this point, it would have reinstated the amended complaint with respect to Phases II and III, and sent the case back to the District Court for discovery and trial. However, the Circuit Court went on to affirm the District Court's judgment on a ground completely outside the ambit of that Court's opinion: that while the defendants had engaged in a pattern of racketeering activity, their association-in-fact enterprise, which committed the "pattern", lacked the continuity necessary for an "enterprise" within the meaning of RICO. Specifically, the Second Circuit held that, because the enterprise ceased to function at the conclusion of the sale of the collateral, it could not be a RICO enterprise. *Id.* at 51-2.

REASONS FOR ALLOWANCE OF THE WRIT

This case grows out of the burgeoning "pattern"

litigation engendered by footnote 14 in this Court's opinion in *Sedima, S.P.R.L. v. Imrex Company, Inc.*, 473 U.S. 479, 105 S. Ct. 3275 (1985).

Since *Sedima*, ten of the twelve Circuit Courts have struggled with the concept of "pattern" and have adopted rules that are not only in mutual conflict, but that in several cases are internally inconsistent. Moreover, the rules of the Second and Fifth Circuits, in which "pattern" litigation has segued into "pattern/enterprise" litigation, are grossly violative of the RICO statute and substantially transcend the possible limits of any mandate on the interpretation of "pattern" suggested by this Court in footnote 14. As a result, the decision in any particular RICO case is almost totally dependent on which Circuit it happens to be filed in, and on which of its rules any particular Circuit decides to apply.

In the interests of (i) the fostering of uniformity of decision among the Circuits, (ii) the preservation of the integrity of the RICO statute and the maintenance of this Court's intended limits on the interpretation of footnote 14, and (iii) the promotion of justice through the uniform treatment of litigants within the respective Circuits, it is respectfully submitted that this Court should grant this petition for certiorari and prescribe a single standard for any future pattern/enterprise litigation.

In order to demonstrate the disparity of the pattern/enterprise rules among the Circuits and the extent to which some of them controvert RICO and *Sedima* or are internally inconsistent, the rules of the ten Circuits that have adopted "pattern" or "pattern/enterprise" rules will be briefly adverted to below. Only the District of Columbia and Sixth Circuits have as yet not adopted any such rules.

First Circuit

In its only "pattern" decision the First Circuit held that the payment of a bribe by a corporation did not constitute a "pattern," even though the bribe had been paid in three installments and had included eleven telephone calls and eight letters that were alleged as "racketeering activity" within the meaning of 18 U.S.C. §1961(1). *Roeder v. Alpha Industries, Inc.*, 814 F. 2d 22, 31-32 (1st Cir. 1987). Because the Court viewed the three installments as a single bribe, it declined to definitively rule on whether a "pattern" must be predicated on racketeering activity involving more than a single scheme or episode, cf. *Superior Oil Co. v. Fulmer*, 785 F. 2d 252, 257 (8th Cir. 1986), but the Court was implicitly critical of the *Superior Oil* decision.

Second Circuit

The Second Circuit has adopted a very liberal view of "pattern," expressly rejecting the "multiple schemes" or "multiple episodes" tests, and requiring only two related predicate acts for the establishment of a pattern. *United States v. Ianniello*, 808 F. 2d 184, 192 (2d Cir. 1986). In enunciating the rule the *Ianniello* Court explicitly relied on *United States v. Weisman*, 624 F. 2d 1118 (2d Cir.), cert. denied, 449 U.S. 871 (1980), which predicated the existence of a pattern on the concept of "enterprise" and the ten-year limitation set forth in §1961(5). *Ianniello, supra*, 808 F. 2d at 190.

The teaching of *Ianniello* and *Weisman* is thus that we must first look to "enterprise" to determine whether there has been a "pattern"; under those cases the finding of a pattern is conclusively determinative of the existence of RICO enterprise. It is a contradiction in terms, under those decisions, to say that there was a pattern of racketeering activity but no RICO enterprise that

committed it. Nevertheless, that is precisely what the Second Circuit held in the instant case, for which certiorari is sought. 820 F. 2d at 51-2.

In engrafting "pattern" considerations onto the concept of "enterprise" the instant case is not only inconsistent with *Ianniello* and *Weisman*, but is also inconsistent with the RICO statute and with this Court's opinion in *Sedima*. Of all the terms set forth in 18 U.S.C. §1961 only "pattern of racketeering activity" is defined in such a way as to fairly permit the judicial engraftment of considerations of quantity or of temporal interpretation. As this Court stated in footnote 14 of *Sedima*, "... the definition of a 'pattern of racketeering activity' differs from the other provisions of §1961 in that it states that a pattern 'requires at least two acts of racketeering activity,' §1961(5) (emphasis added), not that it 'means' two such acts" 105 S. Ct. at 3285 (italics supplied).

In applying "pattern" considerations to "enterprise" the Second Circuit thus violated the definition of enterprise in §1961(4) and transcended the boundary of the mandate of footnote 14 of *Sedima*. Nonetheless, in the recent case of *Furman v. Cirrito*, No. 86-7283, slip op. (2d Cir. September 1, 1987), the Second Circuit reaffirmed the approach it took in the instant case. (The text of the *Furman* opinion is reproduced at Appendix H.) In his dissent in *Furman*, Judge Pratt stated:

While the majority here motors past *Ianniello* with hardly a glance in the rear view mirror, another panel's recent opinion in *Beck v. Manufacturers Hanover Trust Co.*, 820 F. 2d 46 (2d Cir. 1987), rides right over it. There the court acknowledged that *Ianniello* rejects any requirement of multiple episodes to allege a "pattern of racketeering activity"; in the next

breath, however, it brought the multiple-episode concept back to life by engrafting it onto the "enterprise" requirement. The *Beck* court defined "enterprise" as the racketeering episode allegedly engaged in by the defendants, rather than as what the statute describes: the organizational vehicle by or through which the racketeering activity is undertaken. *See United States v. Turkette*, 452 U.S. 576, 583 (1981) ("The 'enterprise' is not the 'pattern of racketeering activity'; it is an entity separate and apart from the pattern of activity in which it engages."). RICO's plain language makes it improper to conflate "continuing enterprise" and "racketeering activity". By equating "enterprise" with "racketeering activity" and then requiring multiple episodes in order to make the enterprise a "continuing enterprise" *Beck* appears to defer to the authority of *Ianniello*. Realistically, however, *Beck* undercuts *Ianniello* by putting back into the RICO stew the multiple-episode ingredient that *Ianniello* sought to remove. Slip op. at 5005-06; Appendix H at 68A-9A.

From the foregoing it is clear that the Second Circuit's decision in the instant case is not only in conflict with §1961(4) and footnote 14 of *Sedima*, but is also inconsistent with the Second Circuit's previous decisions in *Ianniello* and *Weisman*. As will also be clear, it is inconsistent with the rules enunciated by other Circuit Courts on "pattern/enterprise."

Third Circuit

While the Third Circuit has expressly declined to enunciate a definitive "pattern" rule, the cases that have

been decided thus far indicate that that Court is moving toward a position between that of the most liberal decisions, *cf. United States v. Ianniello, supra*; *R.A.G.S. Couture, Inc. v. Hyatt*, 774 F. 2d 1350, 1355 (5th Cir. 1985), and the most restrictive, *cf. Superior Oil Co. v. Fulmer, supra*. See, *United States v. Grayson*, 795 F. 2d 278, 288-90 (3rd Cir. 1986) ("the predicate acts relied upon to support a conviction under RICO must 'have the same or similar purposes, results, participants, victims, or methods of commission, or [must be] otherwise ... interrelated by distinguishing characteristics,' so as not to be 'isolated events'", citing *Sedima*, 105 S. Ct. at 3285 n. 14); *Petro-Tech, Inc. v. Western Co. of North America*, 824 F. 2d 1349, 1354-55 (3rd Cir. 1987) (distinguishing *Superior Oil* on the facts); *Malley-Duff & Associates v. Crown Life Ins. Co.*, 792 F. 2d 341, 354 (3rd Cir. 1986), *aff'd*, ___ U.S. ___, 107 S. Ct. 2759 (1987).

Fourth Circuit

The Fourth Circuit has enunciated a "case-by-case" rule for pattern, ostensibly similar to that of the Seventh Circuit (*infra*). *HMK Corp. v. Walsey*, No. 86-3582, slip op. at 8, 12-13 (4th Cir. September 17, 1987); *International Data Bank, Ltd. v. Zepkin*, 812 F. 2d 149, 154 (4th Cir. 1987). (The text of the *HMK* opinion is reproduced as Appendix K.)

But the opinions in *HMK* and *International Data Bank*, in both of which no "pattern" was found, indicate that the application of the rule by the Fourth Circuit will be considerably more restrictive than that of the Seventh.

Fifth Circuit

The Fifth Circuit, like the Second Circuit in *U.S. v. Ianniello, supra*, adopted in its first post-*Sedima* decision

the most liberal possible reading of "pattern"—that two related predicate acts committed in the course of a single fraudulent scheme are sufficient. *R.A.G.S. Couture, Inc. v. Hyatt*, 774 F. 2d 1350, 1355 (5th Cir. 1985).

Two subsequent decisions appeared to pull back from this position. *Smoky Greenhaw Cotton v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 785 F. 2d 1274, 1280 n. 7 (5th Cir. 1986) (nature of pattern requirement still an open question); *Cowan v. Corley*, 814 F. 2d 223, 226-27 (5th Cir. 1987) ("We read ... *Sedima* to direct a narrower definition of pattern than had been sometimes employed").

Finally, in *Montesano v. Seafirst Corp.*, 818 F. 2d 423, 426-27 (5th Cir. 1987), the Court, deemed bound by *R.A.G.S. Couture*, found the existence of a "pattern", but then engrafted "pattern" considerations onto "enterprise" and dismissed the complaint for lack of a RICO enterprise. This is precisely the state of the law that exists in the Second Circuit, and, for the reasons set forth above, is inconsistent with both the RICO statute and footnote 14 of *Sedima*.

Seventh Circuit

The Seventh Circuit has ostensibly rejected the restrictive "two schemes" or "two episodes" approach to pattern, and adopted a pragmatic, case-by-case approach. *Morgan v. Bank of Waukegan*, 804 F. 2d 970, 975 (7th Cir. 1986) ("predicate acts must be ongoing over an identified period of time so they can fairly be viewed as constituting separate transactions").

However, growing up alongside *Morgan*, in which a "pattern" was found, is a considerably longer line of cases in which it was not. *Lipin Enterprises v. Lee*, 803 F. 2d 322,

324 (7th Cir. 1986) (distinguished in *Morgan* as a single transaction with multiple predicate acts); *Elliott v. Chicago Motor Club Insurance*, 809 F. 2d 347 (7th Cir. 1987) (several acts of mail fraud committed over a period of several years insufficient for a "pattern"); *Skycom Corp. v. Telstar Corp.*, 813 F. 2d 810 (7th Cir. 1987).

These cases illustrate the major deficiency of a case-by-case approach: the distinctions between *Morgan* and the "no pattern" cases may be predicated less on objective considerations than on the Court's subjective reaction to the surrounding circumstances and its formulation of the facts. In most of these cases the Court could have come out either way, with tenable opinions written in support of diametrically opposed results.

Eighth Circuit

The Eighth Circuit has formulated, and consistently applied, the most restrictive "pattern" rule of any Circuit. Under that rule predicate acts—regardless of how many—committed in the furtherance of a single fraudulent scheme are insufficient to constitute a "pattern". *Superior Oil Co. v. Fulmer*, 785 F. 2d 252, 257 (8th Cir. 1986); *Holmberg v. Morrisette*, 800 F. 2d 205 (8th Cir. 1986), *cert. denied*, 107 S. Ct. 1953 (1987); *Madden v. Gluck*, 815 F. 2d 1163 (8th Cir. 1987), *petition for cert. filed*, 56 U.S.L.W. 3067 (U.S. June 3, 1987) (No. 86-1923); *Ornest v. Delaware North Companies*, 818 F. 2d 651 (8th Cir. 1987); *Allright Missouri, Inc. v. Billeter*, No. 86-1476, *slip op.* (8th Cir. September 16, 1987). (The text of the *Allright Missouri* opinion is reproduced as Appendix J.)

In a very recent case, however, two members of an Eighth Circuit panel, while agreeing that the "multiple schemes" rule governs decisions in that Circuit, wrote

concurring opinions indicating their judgment that the rule should be reexamined by the Court *en banc*. *H.J., Inc. v. Northwestern Bell Telephone Co.*, No. 87-5121, slip op. (8th Cir. September 22, 1987). (The text of the opinion is reproduced as Appendix L.)

Ninth Circuit

The Ninth Circuit has adopted a rule that a "pattern" may be predicated on one fraudulent scheme, provided that there is a "threat of continuing activity" on the part of the defendant. The rule appears to require that the defendant's scheme be open-ended, so that but for his having been caught he would have continued the perpetration of the fraud. *TeleVideo Systems, Inc. v. Heidenthal*, No. 86-2129, slip op. (9th Cir. September 2, 1987) (to be published at 826 F. 2d 915; the text of the opinion is reproduced as Appendix I); *Sun Savings & Loan Association v. Dierdorff*, 825 F. 2d 187 (9th Cir. 1987); *Schreiber Distributing Co. v. Serv-Well Furniture Co.*, 806 F. 2d 1393 (9th Cir. 1986).

Tenth Circuit

The Tenth Circuit, like the Ninth, has rejected the "multiple schemes" requirement of the Eighth Circuit, and enunciated a rule that multiple predicate acts committed in connection with a single fraudulent scheme, coupled with a threat of continuing criminal activity, may constitute a "pattern." However, the Tenth Circuit's rule appears to be more circumscribed than the Ninth's: open-ended fraudulent activity involving one scheme and a single victim, even if multi-goaled, may not constitute a "pattern." See, *Condict v. Condict*, 815 F. 2d 579 (10th Cir. 1987); *Torwest DBC, Inc. v. Dick*, 810 F. 2d 925

(10th Cir. 1987).

Eleventh Circuit

The Eleventh Circuit has also adopted a fairly liberal "pattern" rule, expressly rejecting the "multiple schemes" rule of the Eighth Circuit. The Eleventh Circuit rule appears to be of the pragmatic "case-by-case" sort adopted by the Seventh Circuit, with all of its attendant difficulties in factual interpretation. *See, Bank of America v. Touche Ross & Co.*, 782 F. 2d 966, 971 (11th Cir. 1986); *United States v. Watchmaker*, 761 F. 2d 1459, 1475 (11th Cir. 1985).

The Necessity For Review

From the foregoing discussion, it is apparent that the various Circuits have adopted widely divergent—often conflicting—rules regarding "pattern." In the interest of uniformity of result, this Court should now step in to impose order on a chaotic situation.

Moreover, the Second (in the instant case) and Fifth Circuits have violated the RICO statute and transcended the limits of footnote 14 of *Sedima* by appending to the concept of "enterprise" *Sedima's* continuity considerations regarding "pattern". Thus, even absent an attempt to fully rationalize the "pattern" situation, the holding of the Second Circuit in the instant case, and its Fifth Circuit analog, should be reversed.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

Stuart Hecker
Attorney for Petitioners
521 Fifth Avenue
New York, New York 10175
(212) 682-7070

APPENDIX A

OPINION OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK BY THE HON. ROBERT W. SWEET, U.S.D.J., DATED SEPTEMBER 30, 1986

HUBERT PARK BECK, DOROTHY
FAHS BECK, ROBERT J. BECK
and OTTO WEINMANN,
Plaintiffs,

-against-

MANUFACTURERS HANOVER TRUST
COMPANY; MILBANK, TWEED, HADLEY
& McCLOY; KELLEY DRYE & WARREN;
DONALD B. HERTERICH; ISAAC SHAPIRO;
and EDWARD ROBERTS, III,
Defendants.

APPEARANCES:

STUART HECKER, ESQ.
Attorney for Plaintiffs
521 Fifth Avenue
New York, New York 10017

MILBANK, TWEED, HADLEY & McCLOY, ESQS.
Attorneys for Defendants
One Chase Manhattan Plaza
New York, New York 10005
By: KELLEY A. CORNISH, ESQ.
ADLAIS HARDIN, JR., ESQ.
Of Counsel

KELLEY DRYE & WARREN, ESQS.
Attorneys for Defendants
101 Park Avenue
New York, New York 10178

SWEET, D.J.

In this action brought under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §1961 *et seq.*, defendants move to dismiss the amended complaint for failure to state a claim under Fed. R. Civ. P. 12(b)(6) and to plead fraud with particularity under Fed. R. Civ. P. 9(b) and because the action is barred by the applicable statute of limitations. In addition, defendants move to recover costs and attorneys' fees pursuant to Fed. R. Civ. P. 11 and 28 U.S.C. §1927. For the following reasons the motion to dismiss is granted, and the motion to recover costs and fees is denied.

Facts

In 1902, the National Railroad Company of Mexico ("National") issued \$23,000,000 principal amount 4-1/2% Prior Lien Bonds (the "Prior Lien Bonds") and \$27,289,000 First Consolidated Mortgage Bonds (the "Consolidated Mortgage Bonds"). Plaintiffs purportedly hold \$1,500 principal amount of Prior Lien Bonds and \$153,500 of Consolidated Mortgage Bonds. Defendant Manufacturers Hanover Trust Company ("MHT") is the successor trustee for both series of bonds. The other defendants are Donald B. Herterich ("Herterich"), a senior vice-president of MHT; Kelley Drye & Warren ("Kelley Drye"), counsel to MHT; Edward Roberts III ("Roberts"), a Kelley Drye partner; Milbank, Tweed, Hadley & McCloy ("Milbank"), counsel to Mexico; and Isaac Shapiro ("Shapiro"), a Milbank partner at the time of the events alleged.

National is a Utah corporation which in 1902 owned and operated railway lines in Mexico. National also owned certain railway properties in and around Laredo, Texas (the "U.S. collateral"), which it pledged to the trustee as security for, among other issues, the Prior Lien and Consolidated Mortgage Bonds. The Prior Lien Bonds represented a first mortgage against the U.S. collateral and certain collateral located in Mexico; the Consolidated Mortgage Bonds were subordinated to the Prior Lien bonds.

In 1908, under a plan of readjustment and union, National was taken over by Ferrocarriles Nacionales de Mexico ("Ferrocarriles"), a publicly-owned corporation which owns and operates Mexico's railroads. As a result, Ferrocarriles assumed all of National's liabilities, as well as ownership of National's property, including the U.S. collateral securing the bonds.

The bonds have been in default since 1914. In 1942, Mexico issued a decree ("the Registration Decree") requiring holders of certain Mexico securities, including the Prior Lien and Consolidated Mortgage Bonds, to present their bonds for registration to establish non-enemy ownership. In 1951, Mexico promulgated the "Law on the Fate of Enemy Bonds" under which ownership of all bonds not registered was deemed to be vested as property of Mexico.

Approximately 96% of the issued and outstanding Prior Lien and Consolidated Mortgage Bonds were registered under the Registration Decree. The bonds held by plaintiffs were never registered. Pursuant to a 1946 Debt Readjustment Agreement with the International Committee of Bankers, or through direct purchase from bondholders, Mexico acquired all Prior Lien and Consolidated Mortgage Bonds registered under the Registration

Decree.

Between 1942 and 1981, MHT, as indenture trustee, made numerous distributions of accrued and unpaid interest to holders of Prior Lien Bonds. In these and all other distributions, MHT treated the holders of unregistered bonds (including plaintiffs) as the legal owners of the bonds entitled to receive distributions and treated Mexico as the owner of the approximately 96% of the bonds which Mexico had acquired, notwithstanding plaintiffs' objections that Mexico was not entitled to receive distributions as a bondholder.

MHT read Article Four, Section Five of the Prior Lien Trust Indenture to empower a holder of more than 75% of the issued and outstanding Prior Lien Bonds to instruct MHT to foreclose the Prior Lien Mortgage and sell the collateral securing the bonds. Mexico, as holder of approximately 96% of the Prior Lien Bonds, directed MHT to foreclose on the mortgage and sell the U.S. collateral.

The claims asserted in plaintiffs' complaint are based on alleged wrongdoing in connection with the distribution of interest payments to Mexico between 1942 and 1981 ("Phase I"), the sale of the U.S. collateral ("Phase II"), and the disposition of the proceeds of that sale ("Phase III"). In Phase I, defendants allegedly defrauded plaintiffs and similarly situated holders of Prior Lien Bonds by unlawfully treating Mexico as a holder of those bonds with respect to seven distributions of accrued interest from April 1, 1972 through December 31, 1981. Through this treatment defendants allegedly wrongfully permitted more than ninety percent of each such distribution to be siphoned off to Mexico, to the detriment of plaintiffs and other individual holders of Prior Lien Bonds.

In Phase II, defendants allegedly defrauded plaintiffs and similarly situated holders of both series of bonds by

depriving them of substantially the entire value of the collateral held by MHT as indenture trustee through (a) the sale of the collateral at a fraudulently low price, and (b) the treatment of Mexico as a bondholder entitled to 95.83% of the fraudulently low proceeds of the sale.

In Phase III defendants allegedly defrauded the government and the people of Mexico by depriving them of their purported share of the proceeds of the sale of collateral through (a) the sale of the collateral at a fraudulently low price; (b) the failure to disclose to the government of Mexico that it was being defrauded by corrupt Mexican nationals, some of whom were government officials, and that Mexico could have appeared at the sale and purchased the collateral for little or no cash outlay; and (c) the acceptance by MHT of a fraudulent and legally ineffective assignment from the purchaser, in payment of 95.83% of the sale price, given without consideration of Prior Lien Bonds previously recognized by MHT as validly held by Mexico.

Two prior actions based on these facts are now pending against MHT in the Supreme Court of New York County, *Beck v. Manufacturers Hanover Trust Co.*, No. 12396/83 ("Beck I"), and *Beck v. Manufacturers Hanover Trust Co.*, No. 15145/85 ("Beck II"). In *Beck I*, plaintiffs allege that MHT breached its fiduciary responsibilities to plaintiffs as bondholders in its administration of the indenture trust. In *Beck II*, plaintiffs allege that MHT breached its fiduciary responsibilities to plaintiffs as bondholders in the conduct of its defense in *Beck I*.

Statute of Limitations

The provisions of RICO providing for a private cause of action contain no statute of limitations within which actions must be commenced. In the absence of a specific

limitations period in a federal statute creating a private right of action, such as the RICO statute, a court must apply the most appropriate relevant federal statute of limitations, and if there is none, the most relevant state limitations period. *Durante Bros. & Sons, Inc. v. Flushing National Bank*, 755 F. 2d 239, 248 (2d Cir.), *cert. denied*, 105 S. Ct. 3530 (1985); *see also Board of Regents v. Tomanio*, 446 U.S. 478, 485 (1980); *Johnson v. Railway Express Agency Inc.*, 421 U.S. 454 (1975). In a RICO action, state law regarding the length of the limitations period applies. *Durante Bros. & Sons Inc. v. Flushing National Bank*, *supra*, 755 F. 2d at 248.

Because there is no New York state law analogous to RICO, the Second Circuit has held that the three-year statute of limitations in CPLR §214(2) for liabilities created by statute applies. *Durante Bros & Sons Inc. v. Flushing National Bank*, *supra*, 755 F. 2d at 245; *see also Rand v. Anaconda-Ericsson, Inc.*, 623 F. Supp. 176, 182 n.2 (E.D.N.Y. 1985) (assumes that three-year statute of limitations in CPLR §214(3) [sic] applies to RICO actions involving fraud), *aff'd* 794 F. 2d 843 (2d Cir. 1986); *Teltronics Services Inc. v. Anaconda-Ericsson, Inc.*, 587 F. Supp. 724, 733 (E.D.N.Y. 1984) (applies three-year limitations period to RICO action based on fraud), *aff'd*, 762 F. 2d 185 (2d Cir. 1985). But *see Fustok v. Conticommodity Services, Inc.*, 618 F. Supp. 1076, 1081 (S.D.N.Y. 1985) (In view of perceived ambiguity in *Durante* and practical consideration that case was ready for trial and dismissal would be inefficient, court applies six-year statute of limitations in RICO action grounded in fraud.)

While New York state law determines the length of the limitations period under RICO, federal law determines when a RICO cause of action accrues. *See Robertson v. Seidman & Seidman*, 609 F. 2d 583, 587 (2d Cir. 1979); *IIT v. Cornfeld*, 619 F. 2d 909 (2d Cir. 1980); *Seawell v. Miller Brewing Co.*, 576 F. Supp. 424, 427-28 (M.D.N.C. 1983).

Federal law dictates that a cause of action involving fraud accrues "when the plaintiff has actual knowledge of the alleged fraud or knowledge of facts which in the exercise of reasonable diligence should have led to actual knowledge." *IIT v. Cornfeld, supra*, 619 F.2d at 929. Courts uniformly have applied the general federal rule for accrual of RICO claims grounded in fraud. *See Compton v. Ide*, 732 F.2d 1429, 1433 (9th Cir. 1984); *Electronic Relays (India) Pvt., Ltd. v. Pascente*, 610 F. Supp. 648, 653 (N.D. Ill. 1985); *Seawell v. Miller Brewing Co., supra*, 576 F. Supp. at 427-28.

This definition of accrual, however, presupposes that the "fraud" includes injury to the plaintiff. "The general federal rule is that the limitations period begins to run when the plaintiff knows or has reason to know of the injury which is the basis for this action." *Compton v. Ide, supra*, 732 F.2d at 1433 (emphasis added).

The injury to plaintiffs from the sale of the U.S. collateral occurred on November 29, 1982 — the date on which the sale of collateral was closed and title passed from MHT, as trustee, to Mexrail. Prior to the closing no beneficiary of the trust could have maintained an action for damages; the most a beneficiary could have done was attempt to enjoin the sale. This action was instituted on November 29, 1985, exactly three years after the closing. Therefore, the statute of limitations does not bar this action.

RICO

A private cause of action under RICO is authorized by 18 U.S.C. §1964(c), which permits any person injured "by reason of" a violation of 18 U.S.C. §1962 to recover treble damages and attorney's fees. Section 1962 makes it unlawful to (a) invest income "derived ... from a pattern

of racketeering activity" in an interstate enterprise, (b) acquire or maintain an enterprise "through a pattern of racketeering," (c) participate in the conduct of an enterprise "through a pattern of racketeering," or (d) conspire to violate any of these substantive prohibitions. A "pattern of racketeering activity" is defined in §1961(5) to require commission of at least two crimes listed in §1961(1), including mail fraud (18 U.S.C. §1341) and wire fraud (18 U.S.C. §1343).

The requirements for pleading a RICO claim were set forth by the Court of Appeals for the Second Circuit in *Moss v. Morgan Stanley, Inc.*, 719 F. 2d 5, 17 (2d Cir. 1983), *cert. denied*, 465 U.S. 1025 (1984):

[t]o state a claim for damages under RICO a plaintiff has two pleading burdens. First, he must allege that the defendant has violated the substantive RICO statute, 18 U.S.C. §1962 (1976), commonly known as "criminal RICO." In doing so, he must allege the existence of seven constituent elements: (1) that the defendant (2) through the commission of two or more acts (3) constituting a "pattern" (4) of "racketeering activity" (5) directly or indirectly invests in, or maintains an interest in, or participates in (6) an "enterprise" (7) the activities of which affect interstate or foreign commerce. 18 U.S.C. §1962(a)-(c) (1976). Plaintiff must allege adequately defendant's violation of section 1962 before turning to the second burden — i.e., invoking RICO's civil remedies of treble damages, attorney's fees and costs [citations omitted]. To satisfy this latter burden, plaintiff must allege that he was "injured in

his business or property by reason of a violation of section 1962." 18 U.S.C. §1964(c) (1976) (emphasis added).

Accord Sedima, S.P.R.L. v. Imrex Co., 105 S. Ct. 3275, 3285-6 (1985); *Rush v. Oppenheimer & Co.*, 628 F. Supp. 1188, 1192 (S.D.N.Y. 1986). Plaintiffs allege multiple violations of RICO under subsections (a), (b), (c), and (d) of section 1962 against multiple defendants in varying combinations and scenarios.

"Racketeering Activity"

To be liable under RICO, a defendant must engage in a pattern of racketeering activity. 18 U.S.C. §1962(a)-(d). "Racketeering activity" is the violation of one or more enumerated state and federal criminal offences, including mail and wire fraud under 18 U.S.C. §§1341 and 1343. 18 U.S.C. §1961(1).

Plaintiffs rely entirely on allegations of mail and wire fraud to make out the requisite "pattern of racketeering activity" under RICO in each of the ten counts of the amended complaint. Therefore, to sustain this action under RICO, plaintiffs must plead the elements of an indictable offence under the federal mail and wire fraud statutes by showing that each defendant (1) participated in a scheme to defraud, and (2) knowingly used the mails or interstate wires to further the scheme. *E.g., United States v. Gelb*, 700 F. 2d 875, 879 (2d Cir.), cert. denied, 464 U.S. 853 (1983).

Furthermore, to prove mail or wire fraud, plaintiffs must show that the scheme was devised with specific intent to defraud, that any nondisclosures or affirmative misrepresentations were material, and, although the scheme's victims need not have in fact been defrauded,

that some actual harm or injury was at least contemplated. *United States v. Bronston*, 658 F. 2d 920, 927 (2d Cir. 1981) (citing *United States v. Von Barta*, 635 F. 2d 999, 1005 n. 24, 1006 (2d Cir. 1980), cert. denied, 450 U.S. 998 (1981)), cert. denied, 456 U.S. 915 (1982). In addition the statutes are violated when a fiduciary conceals "material information which he is under a duty to disclose to another under circumstances where the non-disclosure could or does result in harm to the other." *United States v. Bronston*, 658 F. 2d 920, 926 (2d Cir. 1981), cert. denied, 456 U.S. 915 (1982); see *United States v. Siegel*, 717 F. 2d 9, 14 (2d Cir. 1983).¹

Plaintiffs need not allege that they were personally defrauded by defendants; rather, they need only allege that they were injured by reason of a scheme to defraud. See, e.g., *SJ Advanced Technology & Mfg. Corp. v. Junkunc*, 627 F. Supp. 572, 575-76 (N.D. Ill. 1986); *Callan v. State Chemical Mfg. Co.*, 584 F. Supp. 619, 623 (E.D. Pa. 1984). Therefore, plaintiffs are not precluded from bringing this action by reason of certain letters from MHT to plaintiffs disclosing its position in administering the Prior Lien Trust or by reason of other knowledge of MHT's activities. Defendants contend, however, that plaintiffs have failed to allege the fraudulent or deceptive nature of any act of omission by defendants.

¹ Although raised in the pleadings, the issue of whether RICO incorporates the elements of common law fraud is not determinative here. While Second Circuit has not specifically discussed the inclusion of common law fraud in mail and wire fraud cases, the specific requirement of a showing of materiality in *Bronston* carries with it some showing of possible reliance. See *Bronston*, 658 F. 2d at 926 (statutes violated "where non-disclosure could or does result in harm") (emphasis added). *

Plaintiffs' complaint alleges a number of misstatements and omissions which it contends were made to defraud (a) the bondholders, other than plaintiffs, who did not tender their bonds in accordance with the 1946 Agreement (the non-assenting bondholders) and (b) Mexico. Plaintiffs allege that the notices mailed and published in connection with the seven interim interest distributions² were fraudulent because they implied, falsely, that MHT was a party to the 1946 Agreement and was obligated to distribute interest to the Fiscal Agent of Mexico rather than the non-assenting bondholders. In fact, plaintiffs claim MHT was distributing interest to Mexico as a bondholder rather than under the 1946 Agreement.

The allegation that MHT relied on Mexico's status as a bondholder in making the distributions must be taken as true for purposes of this motion to dismiss the complaint. *See Miree v. DeKalb County*, 433 U.S. 25, 27 n.2 (1977). While the notice clearly states instead that MHT was distributing interest payments "in accordance with the Assignments provided for in Article IX of [the 1946] Agreement," such a misrepresentation is immaterial as a

² Each of the notices contained the following statement:

In respect of Bonds which have been stamped to indicate assent to the Offer of the United States of Mexico made pursuant to Mexico's agreement with the International Committee of Bankers on Mexico dated February 20, 1946, the amount of such distribution will be paid to the Chase Manhattan Bank, Successor Fiscal Agent of Mexico, in accordance with the assignments provided for in Article IX of said Agreement; and distribution will not be made to the holders of such assenting Bonds. (Emphasis in original of mailed notices only.)

matter of law. All bondholders were fully apprised of the distribution of interest to Mexico or the Fiscal Agent of Mexico, and so no misapprehension as to whom the payment were ultimately being made could have arisen. MHT's inconsistent justifications for making the payment to Mexico could not have induced bondholders to act or refrain from acting, since the only action they might have taken was a lawsuit no different from one they could have brought upon discovery of the "fraud." Furthermore, the bondholders could have simply read the 1946 Agreement for themselves to discover whether MHT could legitimately rely on that document in making the payments. Cf. *Samuelson v. Union Carbide Corp.*, No. 85 Civ. 5373. slip op. at 8 (S.D.N.Y. Jan. 29, 1986) (under New York law, party will not be heard to complain where he has "the means available to him of knowing, by the exercise of ordinary intelligence ... the real quality of the subject of the representation") (quoting *Danann Realty Corp. v. Harris*, 5 N.Y. 2d 317, 322, 184 N.Y.S. 2d 599, 603, 157 N.E. 2d 597 (1959)). From the face of the complaint it is evident that plaintiffs cannot show that the misrepresentation "could or [did] result in harm" to the non-consenting bondholders. See *United States v. Bronston*, 658 F.2d 920, 926 (2d Cir. 1981), *cert. denied*, 456 U.S. 915 (1982).

The remaining claims of fraud arise out of the alleged improper sale of the U.S. collateral. The amended complaint alleges that (1) MHT intentionally misread Article 4, §5 of the Prior Lien Bond indenture to empower a holder of 75% or more in principal amount of the Prior Lien Bonds to direct a sale and procure its own valuations of the collateral, *see Amended Complaint ¶¶ 67-80*; (2) MHT used the valuations to set the upset price for the sale, ¶82, despite the fact that it and the other defendants knew that the valuation of the owned land was only a fraction of its true worth, ¶89; (3) Shapiro discussed by telephone the valuations of certain items of collateral

without disclosing that each of the valuations substantially understated the value of the property, ¶101-103; (4) the Notice of Sale prepared by defendant (a) failed to inform the Consolidated Mortgage Bond holders of their interest in the sale, ¶109(i) & (ii), (b) set forth a sum due on the Prior Lien Bonds that was less than half the sum actually owing on them, ¶109(III), and (c) failed to disclose that the upset price was based on valuations procured by the Mexican nationals; (5) a notice sent to Prior Lien Bondholders on December 20, 1985 and published by newspaper (a) failed to disclose that the sale price was based on fraudulently understated values of the collateral, (b) stated that the amount of the distribution on the assenting bonds was being made to Chase Manhattan as Fiscal Agent when in fact there was to be no such distribution, and (c) failed to disclose that MHT knew that Mexrail's tender of the bonds was fraudulent, ¶118-123; and (6) defendants, particularly Milbank and Shapiro, fraudulently failed to inform Mexico that it could have bid at the sale and received a credit against the sale price that would have resulted in it having only a fraction of the price to pay in cash. ¶¶128-166.

On the pleadings alone, this court cannot conclude that none of these allegations of misrepresentation and nondisclosure state a claim of fraud as required by Fed. R. Civ. P. 12(b)(6). The materiality of the statements and the actual knowledge of the victims of the alleged fraud are issues whose resolution requires more evidence. Nevertheless, these allegations do not withstand a motion to dismiss under Fed. R. Civ. P. 9(b).

Rule 9(b) requires that "all averments of fraud . . . shall be stated with particularity." To satisfy Rule 9(b), the complaint must specify:

(1) precisely what statements were made in

what documents or oral representations or what omissions were made, and

(2) the time and place of each such statement and the person responsible for making (or, in the case of omissions, not making the same),

(3) the content of such statements and the manner in which they misled the [victim], and

(4) what the defendants "obtained as a consequence of the fraud."

Conan Properties, Inc. v Mattel, Inc., 619 F. Supp. 1167, 1172 (S.D.N.Y. 1985) (quoting *Todd v. Oppenheimer & Co.*, 78 F.R.D. 415, 420-421 (S.D.N.Y. 1978)). Plaintiffs' complaint is detailed enough to satisfy the above requirements.³

In addition, although Rule 9(b) provides that intent and "other condition of mind" may be averred generally, plaintiffs must "provide some factual basis for conclusory allegations as to state of mind." *Soper v. Simmons*

³ The memoranda of law raise the question of whether the latter requirement is narrowly what was obtained as a consequence of the fraud or, more broadly, "what was obtained or given up as a consequence of the fraud." 2A J. Moore & J. Lucas, 9-20 through 9-24 (1984). The complaint clearly sets out the victims' alleged loss from a lower sales price.

Whether the plaintiffs must allege that defendants, rather than third parties, benefitted from the fraudulent scheme is a question of substantive law rather than a pleading rule. While trustee's commissions and attorney's fees, funds which presumably would have been received by defendants regardless of any fraud on their part, would hardly seem to be "income derived, directly or indirectly, from a pattern of racketeering activity" within the meaning of §1962(a), it is unnecessary to reach that question here. It will be assumed that the allegations of the victims' losses satisfies Rule 9(b).

Int'l. Ltd., No. 84 Civ. 0070, slip op. at 7 (S.D.N.Y. Feb. 27, 1986) (Sand, J.); *see e.g.*, *Ross v. A. H. Robins Co.*, 607 F.2d 545, 558 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); *Crystal v. Foy*, 562 F. Supp. 422, 426 (S.D.N.Y. 1983) (dismissing complaint on grounds that allegations "provide no basis from which a fair and reasonable inference may be drawn of manipulative and fraudulent conduct") (Weinfeld, J.); *River Plate Reinsurance Co. v. Jay-Mar Group, Ltd.*, 588 F. Supp. 23, 26 (S.D.N.Y. 1984). While plaintiffs have laid out in detail the alleged misrepresentations and nondisclosures, they have not stated facts that support their claim that defendants' acts, in essence alleged breaches of fiduciary duty, were done with the requisite scienter. Plaintiffs' recital of the allegations of the Amended Complaint, *see Memorandum of Plaintiffs in Opposition to Motion to Dismiss*, at 41-45, emphasizes the lack of factual basis for allegations as to state of mind. The facts alleged point to a breach of fiduciary duty rather than fraud. Defendants' only gain was attorneys' and trustees' fees, sums not alleged to be higher than the amounts the defendants would have received absent the alleged fraud. The complaint alleges no facts to provide a reason why the defendants intended to defraud their victims at no benefit to themselves.

"Pattern of Racketeering Activity"

An alternative basis for dismissal of the complaint is plaintiffs' failure to adequately plead a "pattern of racketeering activity." RICO requires not only that a defendant engage in "racketeering activity," but that its commission of racketeering offenses comprise a "pattern." 18 U.S.C. §1962(a)-(d). The statute defines "pattern" as requiring at least two of the enumerated predicate acts within a ten-year period. 18 U.S.C. §1961(5).

In *Sedima, S.P.R.L. v. Imrex Co.*, 105 S. Ct. 3275 (1985),

the Supreme Court indicated that two acts are necessary but not sufficient to create a "pattern." *Id.* at 3285 n. 14. Noting that "in common parlance two of anything do not generally form a 'pattern,'" the Court construed the term "pattern" to require a relationship and continuity between predicate acts. *Id.* While the relationship between the alleged fraudulent acts is apparent and defendants so concede, the "continuity" requirement is sharply in issue here.

This court and others have consistently held that a defendant who commits various criminal acts in the course of one fraudulent scheme has not committed a "pattern of racketeering" under *Sedima*. "Surely the continuity inherent in the term presumes repeated criminal activity, not merely repeated acts to carry out the same criminal activity." *Northern Trust Bank/O'Hare, N.A. v. Inryco, Inc.*, 615 F. Supp. 828, 831 (N.D. Ill. 1985) A pattern "must include racketeering acts sufficiently unconnected in time of substance to warrant consideration as separate criminal episodes." *Allington v. Carpenter*, 619 F. Supp. 474 (C.D. Cal. 1985). A summary of this court's treatment of the "pattern" element appears in *Richter v. Sudman*, No. 85 Civ. 2773 (S.D.N.Y. Apr. 30, 1986) (Goettel, J.). In *Richter*, the defendants allegedly fraudulently induced the plaintiffs to raise capital over a period of months to be invested in defendants' "Tartufo" company, and plaintiffs deposited the funds in an escrow account to be withdrawn only after certain conditions were satisfied. Without the knowledge or consent of plaintiffs, defendants withdrew and spent plaintiffs' funds. Plaintiffs brought an action under RICO, alleging four separate fraudulent schemes by defendants: the first inducing plaintiffs to raise capital, the second inducing plaintiffs to deposit the funds in escrow, the third concealing the withdrawal of the money and the fourth involving the expenditure of the money. In dismissing the action for

failure to plead a "pattern," the *Richter* court articulated several narrow litmus tests for determining whether a "pattern" was alleged, none of which plaintiffs have satisfied here.

First, the court noted that the plaintiffs' articulation of four allegedly separate fraudulent schemes was not enough because "[a]lthough the specific actions underlying each alleged fraud varies, each served a common end, raising money for Tartufo without apparent regard for the interests of potential investors." *See also Crummere v. Brown*, No. 85 Civ. 1376, slip op. at 9 (S.D.N.Y. Apr. 3, 1986) ("[t]he mere fact that [defendants'] alleged fraudulent obtaining of the funds occurred in steps rather than in the securing of a single check comprising the entire amount cannot convert this lone fraudulent scheme into different criminal episodes"); *Superior Oil Co. v. Fulmer*, Nos. 84-2511, 84-2561 (8th Cir. Mar. 5, 1986) (Although the defendants committed numerous predicate acts over a period of years in fraudulently converting gas from plaintiff's pipeline, no "pattern" was established because defendants' actions "comprised one continuing scheme"); *Soper v. Simmons Int'l. Ltd.*, No. 84 Civ. 0070, slip op. at 15-16 (S.D.N.Y. Feb. 27, 1986) (in suit alleging a fraudulent scheme to deprive plaintiffs of commissions in connection with their arrangement of a joint venture agreement between defendants, the court held that defendants' "ministerial acts performed in the execution of a single [allegedly] fraudulent scheme" did not establish a pattern of racketeering activity); *Modern Settings, Inc. v. Prudential-Bache Securities, Inc.*, No. 83 Civ. 6291 (S.D.N.Y. Jan. 8, 1986) (despite the fact that defendants' alleged fraudulent liquidation of plaintiff's securities holdings involved "multiple sales," "each is but a part of a single transaction" and "[t]here is no pattern of racketeering activity in the liquidation alone"); *Professional Assets Management, Inc. v. Penn Square Bank, N.A.*, 616 F. Supp.

1418 (W.D. Okla. 1985) (although many actions went into the preparation and issuance of an allegedly fraudulent audit report, it was a "single, unified transaction" and did not constitute a "pattern"); *Morgan v. Bank of Waukegan*, 615 F. Supp. 836, 838 (N.D. Ill. 1985) (allegations that sale of a 20% interest in a "venture" was part of a plot to deprive plaintiffs of their investment and other property pleaded only a "single plot, though spread over several years from its hatching in 1978 to its fruition in 1982" and was insufficient to constitute a pattern).

Similarly, in the instant action, plaintiffs cannot sidestep the "pattern" requirement by alleging the existence of "two completely different overlapping schemes, the first to defraud the holders of non-assenting bonds (Phase II) and the second to defraud Mexico (Phase III)." The remaining claims of fraud, *see supra*, all involve selling the U.S. collateral for a fraudulently low price—a single transaction.

Moreover, the *Richter* court held that a "pattern" was not established because "there [is no] evidence that this particular scheme is on-going or continuous. Once the defendants dispose of the investors funds, the fraudulent scheme comes to an end." *Richter v. Sudman, supra*; accord *Frankart Distributors, Inc. v. RMR Advertising, Inc.*, 632 F. Supp. 1198, 1201 (S.D.N.Y. 1986) ("There is a distinct and easily defined beginning and end to the transaction at issue here, and all of the alleged predicate offenses ... are merely part of this single transaction."); *Furman v. Cirrito*, No. 82 Civ. 4428 (S.D.N.Y. Mar. 12, 1986) ("There is no allegation ... that this scheme was ongoing. To the contrary, it was time-limited; when the sale was completed, the scheme came to an end."); *Kredietbank, N.V. v. Joyce Morris, Inc.*, No. 84-1903 (D.N.J. Oct. 11, 1985) ("A single matter under litigation is necessarily finite and circumscribed rather than open-ended and potentially

on-going ... [T]he end of the litigation will spell the limit of the enterprises' fraudulent scheme.""). Similarly, in this case, plaintiffs have not pleaded a "pattern" because defendants' alleged fraudulent conduct is not on-going or open-ended—it allegedly began with MHT's intentional misreading of the Prior Lien Bond indenture to empower Mexico to order a sale of the U.S. collateral and, most significantly, ended with the sale of the collateral and distribution of the proceeds of the sale.

Furthermore, this court in *Richter* and other cases, also has required a showing that the defendant has a history of involvement in conduct similar to that alleged in the complaint. *Richter v. Sudman, supra* ("The plaintiffs have not alleged that the defendants have engaged in similar schemes to defraud other investors ... "); *Furman v. Cirrito*, No. 82 Civ. 4428 (S.D.N.Y. Mar. 12, 1986) ("There is no allegation that defendants were involved in other such episodes ... "); *Kredietbank N.V. v. Joyce Morris, Inc.*, No. 84-1903 (D.N.J. Oct. 11, 1985) ("the fact that an enterprise makes it a practice to submit false affidavits in lawsuits in general [rather than in a single lawsuit] ... might well indicate a pattern of unlawful activity"); *Superior Oil Co. v. Fulmer*, Nos. 84-2511, 84-2561 (8th Cir. March 5, 1986) ("There was no proof that [defendants] ha[ve] ever done these actions in the past ... [or] were engaged in other criminal activities elsewhere."); *Fleet Management Systems, Inc. v. Archer-Daniels-Midland Co.*, 627 F. Supp. 550 (C.D. Ill. 1986) (allegations of mail and wire fraud violations in furtherance of a scheme to misappropriate plaintiff's computerized system for routing trucks failed to plead a "pattern" because this "isolated criminal episode" presented no "threat of continuing criminal activity").

Plaintiffs have not met the standards articulated by this court for pleading a "pattern" of racketeering

activity. Accordingly, the Amended Complaint is dismissed.

Since the Amended Complaint sets forth colorable claims under RICO, *see Eastway Constr. Corp. v. City of New York*, 762 F. 2d 243, 253 (2d Cir. 1985), defendants' motion for sanctions under Fed. R. Civ. P. 11 and 28 U.S.C. §1927 is denied.

IT IS SO ORDERED.

Dated: New York, N.Y.
September 30, 1986

ROBERT W. SWEET
U.S.D.J.

APPENDIX B

ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK BY THE HON. ROBERT W. SWEET, U.S.D.J. FILED OCTOBER 15, 1986

HUBERT PARK BECK, DOROTHY FAHS
BECK, ROBERT J. BECK
and OTTO WEINMANN,
Plaintiffs,

-against-

MANUFACTURERS HANOVER TRUST
COMPANY, *et al.*,
Defendants.

U.S. DISTRICT COURT
S.D. OF N.Y.
Filed Oct. 15, 1986

85 Civ. 9361 (RWS)
ORDER

SWEET, J.D.

Pursuant to the opinion of this court filed October 1, 1986, the above action is dismissed with prejudice and without costs to either party.

IT IS SO ORDERED.

DATED: New York, N.Y.
 October 8, 1985

ROBERT W. SWEET
U.S.D.J.

APPENDIX C

OPINION AND ORDER ON REARGUMENT BY THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK BY THE HON. ROBERT W. SWEET, U.S.D.J.

HUBERT PARK BECK, DOROTHY FAHS
BECK, ROBERT J. BECK and OTTO
WEINMANN,

Plaintiffs,

-against-

MANUFACTURERS HANOVER TRUST
COMPANY; MILBANK, TWEED, HADLEY
& McCLOY; KELLEY DRYE & WARREN;
DONALD B. HERTERICH; ISAAC
SHAPIRO and EDWARD ROBERTS III,
Defendants.

85 Civ. 9361 (RWS)

OPINION

APPEARANCES:

STUART HECKER, ESQ.
Attorney for Plaintiffs
521 Fifth Avenue
New York, New York 10017

MILBANK, TWEED, HADLEY & McCLOY, ESQS.
Attorneys for Defendants
One Chase Manhattan Plaza
New York, New York 10005

By: KELLEY A. CORNISH, ESQ.
ADLAIS HARDIN, JR., ESQ.
Of Counsel

KELLEY DRYE & WARREN, ESQS.
Attorneys for Defendants
101 Park Avenue
New York, New York 10178

SWEET, D.J.

Plaintiffs have moved for reargument of defendants' motion to dismiss the Amended Complaint, which was granted by this court's opinion of September 30, 1986. For the reasons stated below, the motion for reargument is granted, and the opinion of September 30, 1986 is affirmed.

In the September 30 opinion, this court dismissed plaintiffs' allegations under the Racketeer Influenced and Corrupt Organizations Act ("RICO") for failure to adequately plead scienter. Plaintiffs now argue that scienter is irrelevant to the predicate acts of mail and wire fraud where the defendant is a fiduciary.

Plaintiffs assert that this court in its September 30 opinion, "recognized that the requirement of a specific intent to defraud is abrogated where the defendant is a fiduciary (*Id.* at 9)." Plaintiffs then cite *United States v. Siegel*, 717 F. 2d 9 (2d Cir. 1983), *United States v. Weiss*, 752 F. 2d 777 (2d Cir.), *cert. denied*, 106 S. Ct. 308 (1985) and *United States v. Newman*, 664 F. 2d 12 (2d Cir. 1981) for the proposition that "the only condition of mind required for the conviction of a fiduciary who has breached his duty is his knowing use of the mails to further the fraudulent scheme."

This court did not make the statement attributed to it by plaintiffs, and none of the cases support plaintiffs' contention that there is no scienter requirement when a fiduciary is accused of fraud. The presence of scienter was not at issue in those cases, because the defendants' alleged intent to defraud was clear. In *United States v. Siegel, supra*, 717 F. 2d at 15, the court held that the defendants took proceeds from unrecorded cash sales and intentionally used the money for their own enrichment. The defendants in *United States v. Newman, supra*, 664 F. 2d at 19, were charged with falsely and fraudulently asserting that they maintained interests in securities trading accounts. The court stated that the fraudulent scheme's "object was to filch from the employer its valuable property by dishonest, devious, reprehensible means." *Id.* (quoting *Abbott v. United States*, 239 F. 2d 310, 324 (5th Cir. 1956)).

In *United States v. Weiss, supra*, 752 F. 2d at 785, the court found that the defendant, among other things, "formulated an elaborate plan, involving phony cash-generating transactions," "created fake feasibility studies and bogus tasks for real estate 'consultants'" and "issued checks for nonperformed legal services." Clearly, the fiduciary defendants in each of the cases cited by plaintiffs acted with scienter.

All three cases cited by plaintiffs to support the proposition that "specific intent to defraud is abrogated where the defendant is a fiduciary" rely on one Second Circuit case, *United States v. Von Barta*, 635 F. 2d 999 (2d Cir. 1980), cert. denied, 450 U.S. 998 (1981). *Von Barta* clearly states that:

to make out a mail fraud violation, the Government must show specific intent to defraud. This specific intent requirement is

sometimes used to distinguish actual and constructive fraud. Actual frauds are intentional frauds. Constructive frauds involve breaches of fiduciary or equitable duties where an intent to deceive is lacking. Only actual frauds are in the purview of the mail fraud statute.

635 F. 2d at 1005 n. 14. Plainly, a fiduciary's specific intent to commit fraud is an element of violations under the mail fraud statute; the term "scheme to defraud" under the mail and wire fraud statutes "connotes some degree of planning by the perpetrators making it essential that the evidence show the defendants entertained an intent to defraud." *Soper v. Simmons Int'l, Ltd.*, 632 F. Supp. 244, 250 (S.D.N.Y. 1986).

Plaintiffs next argue that this court's decision on the "pattern" issue has been implicitly overruled by the Second Circuit's opinion in *United States v. Teitler*, Nos. 85-1364, 85-1382, 85-1404 (2d Cir. Sept. 25, 1986) and expressly overruled by the Seventh Circuit's decision in *Morgan v. Bank of Waukegan*, No. 85-2675 (7th Cir. Oct. 23, 1986).¹

The plaintiffs do not explain the grounds on which *Teitler* overrules this court's decision, and nothing in the *Teitler* decision appears to provide any support for plaintiffs' motion. That opinion does not address the conclusion arrived at in this case, that criminal acts in the course of one fraudulent scheme or single transaction do not constitute a "pattern of racketeering." The charge given

¹ The Seventh Circuit's decision in *Morgan* was brought to this court's attention by letter dated November 21, 1986.

in the lower court and approved in *Teitler* by the Second Circuit merely required the government to prove that the predicate acts "constitute part of a larger pattern of activity," *Teitler, supra*, slip op. at 6033, a conclusion not inconsistent with this court's opinion.

While the Seventh Circuit expressly addresses the proposition that predicate acts under RICO must occur as part of separate schemes in order to constitute a pattern of racketeering activity, *see Morgan v. Bank of Waukegan*, No. 85-2675 (7th Cir. Oct. 23, 1986), and rejects this court's view, that decision is not controlling here. Although this court cited *Northern Trust Bank/O'Hare v. Inryco, Inc.*, 615 F. Supp. 828 (N.D. Ill. 1985), a decision presumably overruled by *Morgan*, it relied as well on precedent in this Circuit for the proposition that more than a single fraudulent scheme must be alleged. *See, e.g., Soper v. Simmons Int'l. Ltd.*, No. 84 Civ. 0070, slip op. at 15-16 (S.D.N.Y. Jan. 8, 1986). This court declines to follow the Seventh Circuit's opinion in *Morgan*.

Therefore, the dismissal of the complaint is affirmed.

IT IS SO ORDERED.

DATED: New York, N.Y.
 December 5, 1986

ROBERT W. SWEET
U.S.D.J.

APPENDIX D

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT No. 922 — August Term 1986

Argued: March 11, 1987 Decided: June 1, 1987
Docket No. 86-7927

HUBERT PARK BECK, DOROTHY FAHS
BECK, ROBERT J. BECK and OTTO
WEINMANN,

Plaintiffs-Appellants,

v.

MANUFACTURERS HANOVER TRUST
COMPANY; MILBANK, TWEED, HADLEY
& McCLOY; KELLEY DRYE & WARREN;
DONALD B. HERTERICH; ISAAC
SHAPIRO; and EDWARD ROBERTS, III,
Defendants-Appellees.

Before: MESKILL and NEWMAN, Circuit
Judges and METZNER, District Judge. *

Appeal from a judgment of the District Court for the
Southern District of New York (Robert W. Sweet, Judge)

* The Honorable Charles M. Metzner of the United States District Court for the Southern District of New York, sitting by designation.

dismissing plaintiffs' action alleging violations by the defendants of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§1961-68 (1982 & Supp. III 1985). 645 F. Supp. 675 (S.D.N.Y. 1986); 650 F. Supp. 48 (S.D.N.Y. 1986).

Affirmed.

Stuart Hecker, New York, N.Y. for plaintiffs-appellants.

Adlai S. Hardin, Jr., New York, N.Y. (Milbank, Tweed, Hadley & McCloy, Kelley, Drye & Warren, New York, N.Y., on the brief), for defendants-appellees.

JON O. NEWMAN, Circuit Judge:

This appeal raises the recurring question whether a complaint adequately pled a violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§1961-68 (1982 & Supp. III 1985). Plaintiffs appeal from a judgment of the District Court for the Southern District of New York (Robert W. Sweet, Judge) dismissing their complaint alleging civil RICO violations by Manufacturers Hanover Trust Co. and other defendants. The complaint was dismissed for failure to plead adequately the scienter element of the alleged predicate acts of mail fraud, 18 U.S.C. §1341 (1982), and wire fraud, 18 U.S.C. §1343 (1982), and, in the alternative, for failure to plead the "pattern" requirement of RICO, 18 U.S.C. §§1961(5), 1962(c). 645 F. Supp. 675 (S.D.N.Y. 1986); 650 F. Supp. 48 (S.D.N.Y. 1986). Because we conclude that the amended complaint does not adequately plead the "enterprise" element of RICO, 18 U.S.C. §§1961(4), 1962(c), we affirm the judgment of the District Court.

Background

The circumstances alleged in the amended complaint are complex. In 1902, National Railroad Company of Mexico ("National"), a Utah corporation, issued \$23,000,000 principal amount of 4-1/2% Prior Lien Bonds ("Prior Lien Bonds") and \$27,289,000 First Consolidated Mortgage Bonds ("Consolidated Mortgage Bonds"). As security for the bonds, National pledged to the trustee certain of its railway properties ("U.S. collateral"). The Prior Lien Bonds represented a first mortgage against the U.S. collateral and certain collateral in Mexico; the Consolidated Mortgage Bonds were subordinated to the Prior Lien Bonds. Article Four, Section Five of the Prior Lien Trust Indenture states that

the holders of seventy-five (75) per cent. in amount of the prior lien bonds outstanding from time to time, shall have the right to direct and to control the method and place of conducting any and all proceedings for any sale of the premises hereby conveyed, mortgaged or pledged, or for the foreclosure of this indenture ...

Plaintiffs Hubert Park Beck, Dorothy Fahs Beck, Robert J. Beck, and Otto Weinmann hold \$1,500 principal amount of Prior Lien Bonds and \$153,500 of Consolidated Mortgage Bonds. Manufacturers Hanover Trust Company ("MHT"), defendant, is the successor trustee for both series of bonds. The other defendants are Donald B. Herterich, a senior vice-president of MHT; Kelley Drye & Warren ("Kelley Drye"), counsel to MHT; Edward Roberts, III, a Kelley Drye partner; Milbank, Tweed, Hadley & McCloy ("Milbank"), counsel to Mexico; and Isaac Shapiro, a Milbank partner at the time of the events alleged.

In 1908, Ferrocarriles Nacionales de Mexico ("Ferrocarriles"), a publicly owned Mexican corporation which owns and operates Mexico's railroads, took over National. Through this transaction, Ferrocarriles assumed all of National's liabilities and ownership of National's property, including the U.S. collateral securing the bonds.

National defaulted on interest payments on the bonds in 1914. In 1942, Mexico issued a decree ("the Registration Decree") requiring holders of certain Mexico securities, including the Prior Lien Bonds and Consolidated Mortgage Bonds, to register their bonds to establish non-enemy ownership. In 1951, Mexico promulgated the "Law on the Fate of Enemy Bonds" under which Mexico acquired ownership of all unregistered bonds.

Approximately 96% of the issued and outstanding Prior Lien and Consolidated Mortgage Bonds were registered under the Registration Decree. Plaintiffs' bonds were never registered. Pursuant to a 1946 Debt Readjustment Agreement with the International Committee of Bankers on Mexico and through open market purchases from bondholders, Mexico had by November 1982 acquired all Prior Lien and Consolidated Mortgage Bonds registered under the Registration Decree. Plaintiffs allege that bonds redeemed by Mexico pursuant to the Debt Readjustment Agreement were to have been retired by January 1, 1975.

Between 1942 and 1981, MHT, as indenture trustee, made numerous distributions of accrued and unpaid interest to holders of Prior Lien Bonds. Despite the Law on the Fate of Enemy Bonds, MHT treated the holders of unregistered bonds as legal owners of the bonds entitled to receive distributions. In addition, MHT treated Mexico as the owner of approximately 96% of the bonds it had acquired, notwithstanding plaintiffs' objections that

Mexico was not entitled to receive distributions as a bondholder in view of the Debt Readjustment Agreement.

Mexico, acting pursuant to Article Four, Section Five of the Prior Lien Trust Indenture, instructed MHT to foreclose the Prior Lien Mortgage and sell the U.S. collateral at a public auction on November 2, 1982. Following appraisal of the U.S. collateral, an upset price of \$31 million was determined. The public auction and the upset price were published in a notice of sale dated August 10, 1982. At the auction, Mexrail, Inc., the sole bidder, purchased the U.S. collateral for the upset price. The sale was consummated on November 29, 1982. In December 1982, MHT published and mailed to known bondholders a notice stating that it would distribute \$1,355 of accrued and unpaid interest from the proceeds of the sale of U.S. collateral on each \$1,000 Prior Lien Bond presented.

In March 1983, plaintiffs instituted an action in Supreme Court, New York County, alleging that MHT breached its fiduciary responsibilities in its administration of the indenture trust. *Beck v. Manufacturers Hanover Trust Co.*, No. 12896/83 ("Beck I"). Plaintiffs later instituted a second lawsuit in New York alleging that MHT breached its fiduciary responsibilities in the conduct of its defense in *Beck I*. *Beck v. Manufacturers Hanover Trust Co.*, No. 15145/85.

In November 1985, plaintiffs brought a civil RICO action against defendants in the District Court for the Southern District of New York alleging wrongdoing in connection with the interest payments to Mexico between 1942 and 1981, the sale of U.S. collateral, and the disposition of the proceeds of that sale. The amended complaint alleges a three-phase conspiracy. During Phase I,

defendants allegedly defrauded non-assenting bondholders by paying interest to Mexico in violation of the Debt Readjustment Agreement. During Phase II, defendants allegedly defrauded non-assenting bondholders by depriving them of substantially the entire value of the U.S. collateral by selling it at an artificially low price and by treating Mexico as a bondholder entitled to approximately 96% of the proceeds of the sale. During Phase III, defendants allegedly defrauded the Government and people of Mexico by depriving them of their purported share of the proceeds of the sale of the U.S. collateral through the low sale price, the failure to disclose to the Government of Mexico that it was being defrauded by its nationals, and the acceptance by MHT of a fraudulently and legally ineffective assignment of approximately 96% of the Prior Lien Bonds from Mexrail, Inc. in substantial satisfaction of the sale price of the U.S. collateral.

Defendants moved to dismiss the amended complaint pursuant to Fed. R. Civ. P. 12(b)(6) and 9(b) and for failure to adhere to the applicable statute of limitations. Judge Sweet granted defendants' motion to dismiss on the alternative grounds that plaintiffs had not adequately pled "racketeering activity" or a "pattern of racketeering activity" as required by RICO. 645 F. Supp. 675 (S.D.N.Y. 1986). Judge Sweet later heard reargument but adhered to his prior ruling. 650 F. Supp. 48 (S.D.N.Y. 1986).

Discussion

The gravamen of plaintiffs' amended complaint is that defendants violated RICO through their involvement in the allegedly improper treatment of bonds held by Mexico and the sale and disposition of the proceeds of the U.S. collateral. One component of a viable claim for damages under RICO is a proper allegation that defendants committed two or more "predicate" acts, 18 U.S.C.

§1961(1), constituting a "pattern of racketeering activity." 18 U.S.C. §§1961(5), 1962, 1964(c). See *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 495-96 (1985); *Moss v. Morgan Stanley, Inc.*, 719 F.2d 5, 17 (2d Cir. 1983), cert. denied, 465 U.S. 1025 (1984). Plaintiffs' amended complaint alleged multiple violations of the mail fraud statute, 18 U.S.C. §1341, and the wire fraud statute, 18 U.S.C. §1343, as the predicate acts committed by the defendants. The initial question on this appeal is whether the amended complaint pled the scienter element of these violations with sufficient detail to satisfy Fed. R. Civ. P. 9(b).

1. Adequacy of Pleading Scienter

In general, the mail and wire fraud statutes require, *inter alia*, a showing of intentional fraud. See *United States v. Von Barta*, 635 F.2d 999, 1005 n. 14 (2d Cir. 1980), cert. denied, 450 U.S. 998 (1981); *Soper v. Simmons Int'l, Ltd.*, 632 F. Supp. 244, 250 (S.D.N.Y. 1986). Although Rule 9(b) provides that intent and "other condition of mind" may be averred generally, plaintiffs must nonetheless provide some factual basis for conclusory allegations of intent. *Connecticut National Bank v. Fluour Corp.*, 808 F.2d 957, 962 (2d Cir. 1987); *Ross v. A.H. Robins Co.*, 607 F.2d 545, 558 (2d Cir. 1979), cert. denied, 446 U.S. 946 (1980); *Soper v. Simmons Int'l, Ltd.*, *supra*, 632 F. Supp. at 249. These factual allegations must give rise to a "strong inference" that the defendants possessed the requisite fraudulent intent. See *Connecticut National Bank v. Fluour Corp.*, *supra*, 808 F.2d at 962; *Ross v. A.H. Robins Co.*, *supra*, 607 F.2d at 558.

A common method for establishing a strong inference of scienter is to allege facts showing a motive for committing fraud and a clear opportunity for doing so. See, e.g., *Goldman v. Belden*, 754 F.2d 1059, 1070 (2d Cir. 1985). Where motive is not apparent, it is still possible to plead scienter by identifying circumstances indicating

conscious behavior by the defendant, *see United States v. Simon*, 425 F. 2d 796, 808-09 (2d Cir. 1969), *cert. denied*, 397 U.S. 1006 (1970); *cf. Gibbons v. Udaras na Gaeltachta*, 549 F. Supp. 1094, 1124 (S.D.N.Y. 1982), though the strength of the circumstantial allegations must be correspondingly greater, *cf. United States v. Simon, supra*, 425 F. 2d at 808-10.

The present case falls into the latter category of cases. Plaintiffs have not alleged any facts indicating motive on the part of defendants. They concede that defendants did not stand to gain financially from the allegedly fraudulent transactions. They base their allegations of scienter solely on the circumstances surrounding the interest payments to Mexico and the sale of the U.S. collateral.

Plaintiffs' amended complaint does not provide an adequate basis for the requisite inference of scienter with respect to Phase I of the alleged conspiracy. Throughout the period 1942 to 1981, MHT consistently adhered to a practice of paying interest to all holders of Prior Lien Bonds, including Mexico. These interest payments to Mexico were disclosed in MHT's notices of distribution. Plaintiffs failed to identify any circumstances related to these interest payments indicating an intent by the defendants to defraud the non-assenting bondholders. At most, plaintiffs have alleged that MHT breached its fiduciary duty by paying interest to Mexico after its bonds were to have been retired.

With respect to Phases II and III of the alleged conspiracy, however, plaintiffs have adequately pled scienter. Plaintiffs alleged two sets of unusual circumstances surrounding the sale of the U.S. collateral that give rise to a strong inference of scienter. The first set involves the manner in which the upset price for the U.S. collateral was determined. Plaintiffs alleged, with supporting documents, that the valuations underlying this determination

were procured by Mexican nationals who eventually purchased the collateral for the upset price. Plaintiffs also alleged facts indicating that the sale of the U.S. collateral was made in violation of the Hart-Scott-Rodino Antitrust Improvement Act of 1976, Pub. L. No. 94-435, 90 Stat. 1383, which requires prenotification of federal authorities regarding specified sales of assets, 15 U.S.C. §18A (1982 & Supp. III 1985). Plaintiffs' asserted reason for this violation was the Mexican nationals' need to consummate the sale prior to the change of Mexican administration on December 1, 1982. Defendants have not offered any alternate explanation for either of these sets of circumstances. These circumstances, read in the context of plaintiffs' other allegations, create, for purposes of testing the validity of a complaint a strong inference that defendants consciously engaged in activities enabling the Mexican nationals to acquire the U.S. collateral at a fraudulently low price.

Consequently, we hold that the District Court erred in ruling that none of plaintiffs' allegations of mail and wire fraud adequately pled scienter. We affirm Judge Sweet's ruling that plaintiffs failed to allege scienter adequately with respect to Phase I but reverse his holding that the allegations of scienter with respect to Phases II and III were inadequate.

2. Adequacy of Pleading "Pattern of Racketeering Activity"

The District Court ruled, as an alternative ground for dismissal, that plaintiffs' amended complaint failed to plead adequately a "pattern of racketeering activity." Sharing a view expressed elsewhere, e.g., *Superior Oil Co. v. Fulmer*, 785 F. 2d 252, 257 (8th Cir. 1986), Judge Sweet interpreted footnote 14 of *Sedima, S.P.R.L. v. Imrex Co.*, *supra*, 473 U.S. at 496, to impose a "multiple episodes"

requirement upon the "pattern" element of RICO. See 645 F. Supp. at 683-85; 650 F. Supp. at 50. Applying this standard, Judge Sweet concluded that plaintiffs had failed to allege a RICO pattern.

On the day preceding issuance of Judge Sweet's final decision ordering dismissal, and apparently after his reconsideration, our Circuit decided *United States v. Ianniello*, 808 F. 2d 184 (2d Cir. 1986), which considers the effect of *Sedima*'s footnote 14 on our Circuit's interpretation of the "pattern" element of RICO. Judge Mahoney expressly rejected a multiple episodes requirement, *id.* at 190, 192 n. 15; he did, however, highlight that our Circuit has given effect to the factor of "continuity plus relationship" discussed in *Sedima* through our interpretation of the "enterprise" element of RICO, 18 U.S.C. §§1961(4), 1962(c). *Id.* at 191.

It is clear after *Ianniello* that the District Court erred in interpreting "pattern of racketeering activity" to require multiple episodes. *Ianniello* confirms that two related predicate acts will suffice to establish a pattern under 18 U.S.C. §1961(5). *Id.* at 189-90. Plaintiffs' amended complaint pleads at least two related acts of mail and wire fraud with regard to the sale of the U.S. collateral and therefore satisfies the pleading requirement for "pattern of racketeering activity."

3. Adequacy of Pleading "Enterprise"

Focusing on the solace provided by *Ianniello*, defendants argue that the District Court's judgment should be affirmed on the ground that plaintiffs' amended complaint fails to allege adequately a RICO enterprise. *Ianniello* emphasizes that a plaintiff must prove the existence of a continuing enterprise under 18 U.S.C. §1962(c):

An enterprise is "a group of persons associated together for a common purpose of engaging in a course of conduct" and "is proved by evidence of an ongoing organization, formal or informal, and by evidence that the various associates function as a continuing unit." *United States v. Turkette*, 452 U.S. 576, 583, 101 S. Ct. 2524, 2528, 69 L. Ed. 2d 246 (1981). This circuit requires that, under section 1962(c), the enterprise be a continuing operation and that the [predicate] acts be related to the common purpose.

Id. at 191 (emphasis added).

Defendants' contention is significantly strengthened by our holding above the plaintiffs have sustained their pleading burden with regard to only those predicate acts associated with the sale of the U.S. collateral. As *Ianniello* recognized, whether one looks for the requisite continuity and relatedness by examining the pattern or the enterprise is really a matter of form, not substance. *Id.* at 191. A consequence of that observation for this case is that with the elimination of Phase I from consideration, the enterprise alleged by plaintiffs had but one straightforward, short-lived goal—the sale of the U.S. collateral at a reduced price. At the conclusion of the sale, the alleged enterprise ceased functioning. Cf. *United States v. Ianniello*, *supra*, 808 F. 2d at 191-92 (noting that "[t]he common purpose in this case was to skim profits and had no obvious terminating goal or date" (emphasis added)). Such an association is not sufficiently continuing to constitute an "enterprise" under 18 U.S.C. §§1961(4), 1962(c). Cf. *Moss v. Morgan Stanley Inc.*, *supra*, 719 F. 2d at 22; *United States v. Mazzei*, 700 F. 2d 85, 89 (2d Cir.), *cert. denied*, 461 U.S. 945 (1983). For lack of an adequate allegation of a RICO enterprise, the complaint

was vulnerable to dismissal.

The judgment of the District Court is affirmed.

APPENDIX E

ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT FILED ON JUNE 1, 1987

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 1st day of June one thousand nine hundred and eighty-seven.

Present: HON. THOMAS J. MESKILL,
 HON. JON O. NEWMAN,
 Circuit Judges,
 HON. CHARLES M. METZNER,
 District Judge.

United States Court of Appeals
Second Circuit
Filed
June 1, 1987
Elaine B. Goldsmith, Clerk

U.S. DISTRICT COURT
S.D. OF N.Y.
FILED
JUL. 24, 1987
#87,1368

* The Honorable Charles M. Metzner of the United States District Court for the Southern District of New York, sitting by designation.

HUBERT PARK BECK, DOROTHY FAHS
BECK, ROBERT J. BECK and OTTO
WEINMANN,

Plaintiffs-Appellants,

-v.-

MANUFACTURERS HANOVER TRUST
COMPANY; MILBANK, TWEED, HADLEY
& McCLOY; KELLEY DRYE & WARREN;
DONALD B. HERTERICH; ISAAC
SHAPIRO; and EDWARD ROBERTS, III,

Defendants-Appellees.

No. 86-7927

Appeal from the United States District Court for the
Southern District of New York.

This cause came on to be heard on the transcript of
record from the United States District Court for the South-
ern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby
ordered, adjudged, and decreed that the Judgment of said
District Court be and it hereby is affirmed in accordance
with the opinion of this court with costs to be taxed
against the appellants.

A TRUE COPY
ELAINE B. GOLDSMITH

Elaine B. Goldsmith,
Clerk

s/

s/

By: Edward J. Guardaro,
Deputy Clerk

APPENDIX F

ORDER OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT DENYING PETITION FOR REHEARING, ENTERED JULY 14, 1987

UNITED STATE COURT OF APPEALS FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 14th day of July one thousand nine hundred and eighty-seven.

HUBERT PARK BECK, DOROTHY FAHS
BECK, ROBERT J. BECK and OTTO
WEINMANN,

Plaintiffs-Appellants,

-v.-

MANUFACTURERS HANOVER TRUST
COMPANY; MILBANK, TWEED, HADLEY
& McCLOY; KELLEY DRYE & WARREN;
DONALD B. HERTERICH; ISAAC
SHAPIRO; and EDWARD ROBERTS, III,
Defendants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by plaintiffs-appellants Hubert Park Beck, et al.,

Upon consideration by the panel that heard the

appeal it is

ORDERED that said petition for rehearing is
DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

s/
Elaine B. Goldsmith,
Clerk

APPENDIX G

TEXT OF 18 U.S.C. §§ 1961 AND 1962

§1961. Definitions

As used in this chapter [18 USCS §§ 1961 et seq.]—

(1) “racketeering activity” means (A) any act or threat involving murder, kidnapping, gambling, arson, robbery, bribery, extortion, or dealing in narcotic or other dangerous drugs, which is chargeable under State law and punishable by imprisonment for more than one year; (B) any act which is indictable under any of the following provisions of title 18, United States Code: Section 201 (relating to bribery), section 224 (relating to sports bribery), sections 471, 472, and 473 (relating to counterfeiting), section 659 (relating to theft from interstate shipment) if the act indictable under section 659 is felonious, section 664 (relating to embezzlement from pension and welfare funds), sections 891-894 (relating to extortionate credit transactions), section 1084 (relating to the transmission of gambling information), section 1341 (relating to mail fraud), section 1343 (relating to wire fraud), section 1503 (relating to obstruction of justice), section 1510 (relating to obstruction of criminal investigations), section 1511 (relating to the obstruction of State or local law enforcement), section 1951 (relating to interference with commerce, robbery, or extortion), section 1952 (relating to racketeering), section 1953 (relating to interstate transportation of wagering paraphernalia), section 1954 (relating to unlawful welfare fund payments), section 1955 (relating to the prohibition of illegal gambling businesses), sections 2314 and 2315 (relating to interstate transportation of stolen property), sections 2341-2346 (relating to trafficking

in contraband cigarettes), sections 2421-24 (relating to white slave traffic), (C) any act which is indictable under title 29, United States Code, section 186 [29 USCS §186] (dealing with restrictions on payments and loans to labor organizations) or section 501(c) [29 USCS-§501(c)] (relating to ~~embezzlement~~ from union funds), or (D) any offense involving bankruptcy fraud, fraud in the sale of securities, or the felonious manufacture, importation, receiving, concealment, buying, selling, or otherwise dealing in narcotic or other dangerous drugs punishable under any law of the United States;

(2) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, any political subdivision, or any department, agency, or instrumentality thereof;

(3) "person" includes any individual or entity capable of holding a legal or beneficial interest in property;

(4) "enterprise" includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity;

(5) "pattern of racketeering activity" requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter [enacted Oct. 15, 1970] and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity;

(6) "unlawful debt" means a debt (A) incurred or contracted in gambling activity which was in violation of the law of the United States, a political subdivision thereof, or which is unenforceable under State or Federal law in whole or in part as to principal or interest because of the laws relating to usury, and (B) which was incurred in connection with the business of gambling in violation of the law of the United States,

a State or political subdivision thereof, or the business of lending money or a thing of value at a rate usurious under State or Federal law, where the usurious rate is at least twice the enforceable rate;

(7) "racketeering investigator" means any attorney or investigator so designated by the Attorney General and charged with the duty of enforcing or carrying into effect this chapter [18 USCS §§ 1961 et seq.];

(8) "racketeering investigation" means any inquiry conducted by any racketeering investigator for the purpose of ascertaining whether any person has been involved in any violation of this chapter [18 USCS §§ 1961 et seq.] or of any final order, judgment, or decree of any court of the United States, duly entered in any case or proceeding arising under this chapter [18 USCS §§ 1961 et seq.];

(9) "documentary material" includes any book, paper, document, record, recording, or other material; and

(10) "Attorney General" includes the Attorney General of the United States, the Deputy Attorney General of the United States, any Assistant Attorney General of the United States, or any employee of the Department of Justice or any employee of any department or agency of the United States so designated by the Attorney General to carry out the powers conferred on the Attorney General by this chapter [18 USCS §§ 1961 et seq.]. Any department or agency so designated may use in investigations authorized by this chapter [18 USCS §§ 1961 et seq.] either the investigative provisions of this chapter [18 USCS §§ 1961 et seq.] or the investigative power of such department or agency otherwise conferred by law.

§1962. Prohibited activities

(a) It shall be unlawful for any person who has received

any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code [18 USCS §2], to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. A purchase of securities in the open market for purposes of investment, and without the intention of controlling or participating in the control of the issuer, or of assisting another to do so, shall not be unlawful under this subsection if the securities of the issuer held by the purchaser, the members of his immediate family, and his or their accomplices in any pattern of racketeering activity or the collection of an unlawful debt after such purchase do not amount in the aggregate to one percent of the outstanding securities of any one class, and do not confer, either in law or in fact, the power to elect one or more directors of the issuer.

- (b) It shall be unlawful for any person through a pattern of racketeering activity or through collection of unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce.
- (c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.
- (d) It shall be unlawful for any person to conspire to

violate any of the provisions of subsections (a), (b), or (c) of this section.

APPENDIX H

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT IN *FURMAN V. CIRRITO, NO. 86-7283, SLIP OP. (2D CIR. SEPTEMBER 1, 1987)*

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 18—August Term, 1986
(Argued October 20, 1986 Decided September 1, 1987)
Docket No. 86-7283

AARON J. FURMAN, MARTIN J. JOEL, JR., ALVIN
KATZ, FRANCIS P. MAGLIO, HARVEY SHEID, EVER-
ARD M.C. STAMM and ROBERT C. STAMM,
Plaintiffs,

MARTIN J. JOEL, JR., HARVEY SHEID, EVERARD
M.C. STAMM and ROBERT C. STAMM,
Plaintiffs-Appellants,

-v.-

JOHN CIRRITO, HAROLD S. COLEMAN, JOHN A.
MILLER, FRANCIS G. REA, PETER M. TOCZEK and
A.J. YORKE,
Defendants-Appellees.

Before:

VAN GRAAFEILAND, NEWMAN and PRATT,
Circuit Judges.

Appeal from an order and judgment of the United States District Court for the Southern District of New York (Cooper, J.), dismissing a complaint for failure to allege a "pattern of racketeering activity" under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§1961-68, and for a resulting lack of subject matter jurisdiction over its pendent state law claims. Affirmed. Judge Pratt dissents in a separate opinion.

SEYMOUR SHAINSWIT, New York, N.Y.
(Cooper Cohen Singer Ecker & Shainswit and Steven E. Livitsky, N.Y., N.Y., of Counsel), *for Plaintiffs-Appellants.*

MAX GITTER, New York, N.Y. (Paul, Weiss, Rifkind, Wharton & Garrison and Dorothy E. Roberts, N.Y., N.Y., of Counsel), *for Defendants-Appellees.*

VAN GRAAFEILAND, *Circuit Judge*

This is an appeal from an order of the United States District Court for the Southern District of New York (Cooper, J.) granting appellees' motion under Fed. R. Civ. P. 12(b)(1) and (6) to dismiss appellants' complaint, and from the judgment entered pursuant thereto. For the reasons that follow, we affirm.

Appellants' complaint states three causes of action, two that are state law claims of partnership fraud and breach of fiduciary duty and a third grounded on the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§1961-68. It twice has been dismissed by the district court. The first dismissal was based on appellants' failure to allege a separate, distinct racketeering enterprise injury. 578 F. Supp. 1535 (S.D.N.Y. 1984). This Court's affirmance of that decision, 741 F.2d 524, was

vacated by the Supreme Court, 105 S. Ct. 3550 (1985), on the basis of its holdings in *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479 (1985), and *American Nat'l Bank & Trust Co. v. Haroco, Inc.*, 473 U.S. 606 (1985) (per curiam). Following remand to the district court, appellees moved to dismiss for failure to allege a "pattern of racketeering activity", 18 U.S.C. §1962(c), or, in the alternative, to compel arbitration pursuant to the Federal Arbitration Act, 9 U.S.C. §§1-14. Relying on *Sedima, supra*, 473 U.S. at 496 n. 14; *id.* at 527-28 (Powell, J., dissenting), and cases that followed, the district court held that racketeering activity must be continuous and related in order to constitute a pattern and must be ongoing or occur in more than one criminal episode. Although the district court felt that appellees' alleged acts were related, it concluded that the complaint failed to allege any continuity of activity, and dismissed the RICO cause of action. The district court held that it then lacked subject matter jurisdiction over appellants' state law claims, and refused to address appellees' motion to arbitrate.

Because the issue on the first appeal was whether a RICO complaint must allege a racketeering injury separate and apart from that which resulted from "the predicate acts of using mail and wire facilities in violation of 18 U.S.C. §§1341 and 1343" (741 F. 2d at 526), precise factual allegations were treated in summary fashion only and played no determinative role in our decision. Disposition of the present appeal requires that we take cognizance of certain conceded and undisputed facts and recent substantial changes in the law of mail fraud. Although appellees' motion was made under Rule 12(b)(1) and (6), the record before us consists of more than just the complaint. Specifically, it includes the partnership agreement, which spells out the rights and obligations of the parties, the contract for the sale of the partnership assets, whose terms appellants claim were unfair, and affidavits

of counsel for both sides. The district court might have treated the motion as one for summary judgment. *See In re G. & A. Books, Inc.*, 770 F. 2d 288, 295 (2d Cir. 1985), cert. denied, 106 S. Ct. 1195 (1986); *Grand Union Co. v. Cord Meyer Development Corp.*, 735 F. 2d 714, 716-17 (2d Cir. 1984). Despite its failure to do so, we nonetheless may refer to the partnership agreement and contract of sale, which are integral parts of appellants' claim and of the record before us. *See Decker v. Massey-Ferguson, Ltd.*, 681 F. 2d 111, 113 (2d Cir. 1982); 5 Wright & Miller, *Federal Practice and Procedure* §§1327, 1357 at 593. Examining the complete picture thus presented, we are unable to discover a sufficient allegation of a "pattern of racketeering activity" conducted in the affairs of an "enterprise", *United States v. Ianniello*, 808 F. 2d 184, 190 (2d Cir. 1986), cert. denied, 55 U.S.L.W. 3849 (June 23, 1987); indeed, we have difficulty in discovering a sufficient allegation of racketeering activity at all.

In a complaint based almost entirely on information and belief, appellants accuse appellees of a RICO violation based on the predicate crime of mail fraud. We have, we believe, made it clear that we look with a jaundiced eye upon allegations of fraud based upon information and belief. *Luce v. Edelstein*, 802 F. 2d 49, 54 n. 1 (2d Cir. 1986); *Decker v. Massey-Ferguson, Ltd.*, *supra*, 681 F. 2d at 114. Nevertheless, we have carefully reviewed the complaint, in light of the undisputed documents, in an attempt to understand how appellants are attempting to meet their obligation to allege statutorily required charges of criminal wrongdoing. *See United States v. Angelilli*, 660 F. 2d 23, 34-35 (2d Cir. 1981), cert. denied, 445 U.S. 910, 945 (1982). Moreover, unlike the district court in the two hearings before it and this Court on the prior appeal, we have determined the sufficiency of appellants' allegations in accordance with the Supreme Court's "crabbed" construction of the mail fraud statute in

McNally v. United States, No. 86-234, slip op. (June 24, 1987) (Quote is from Justice Stevens' dissenting opinion at 14).

Appellants' RICO allegations, stated succinctly, are as follows:

1. Prior to August 7, 1981, appellants and appellees were general partners in a limited brokerage partnership known as Bruns, Nordeman, Rea & Co. (Bruns).
2. Appellees Coieman and Rea were Bruns Managing Directors, and, by the terms of the written partnership agreement, they "were empowered to sell all or substantially all of the assets of Bruns 'on behalf of all of the partners' on such terms and conditions as they, in their sole discretion, approved."
3. During May and June of 1981, Rea and several members of the Executive Committee negotiated with Bache, Halsey, Stuart, Shields, Inc. (Bache) for the sale to Bache of all or substantially all of Bruns' assets.
4. A preliminary agreement on the terms of the purchase contract was reached on June 30, 1981, and a letter of intent was signed on July 2, 1981.
5. On July 6, 1981, appellants were informed of the deal, which was described as a *fait accompli*, whose terms could not be altered.
6. At a firm meeting on July 23, 1981, appellants learned for the first time that their signatures would be required on the purchase agreement that was to be executed.
7. On July 27, 1981, all of the appellants executed the

agreement.

8. Appellants were defrauded because they were not told "in a timely manner" that their signatures would be required, that as a result some of the partners were secretly favored over others and appellees did not discharge their "duty of finding the potential purchaser willing to make the largest offer for Bruns' assets."

It is readily apparent that the crucial element in appellants' claim of mail fraud is appellees' alleged failure to promptly inform them that they would have to sign an eventual agreement with Bache. We think that, as an allegation of criminal wrongdoing, this claim borders on the specious.

It is undisputed that, although appellants and appellees were general partners in Bruns, their interests in the firm were far from identical. The six appellees accounted for 75 percent of the general partners' equity, and the remaining 25 percent was allocated among seven partners, four of whom are now appellants. In view of appellees' substantially greater financial interests, it is not surprising that, between them, they comprised the firms' Managing Directors and Executive Committee, which together had the primary responsibility for Bruns' operations.

It is likewise not surprising that, under the terms of the partnership agreement, the Managing Directors had "full power and authority on behalf of all of the partners, at any time, to sell or otherwise transfer all or substantially all of assets and business of the partnership, on such terms and conditions as the Managing Directors, in their sole discretion, [might] approve." The agreement also provided that it would terminate automatically upon the sale of all or substantially all of the partnership assets as an entirety

or the merger or consolidation of the partnership with or into another partnership or corporation. Upon such termination, the Executive Committee was to liquidate the partnership.

The rights and obligations of partners, as between themselves, are fixed by the terms of the partnership agreement. *Levy v. Leavitt*, 257 N.Y. 461, 466 (1931). "If complete, as between the partners, the agreement so made controls." *Lanier v. Bowdoin*, 282 N.Y. 32, 38 (1939). Even terms which permit self-dealing by a partner will be enforced. *Riviera Congress Assocs. v. Yassky*, 25 A.D. 2d 291, 295, *aff'd* 18 N.Y. 2d 540 (1966); *Raymond v. Brimberg*, 99 A.D. 2d 988 (1984) (*mem.*); *Crane and Bromberg on Partnership*, sec. 5 at 43 (1968). Since appellees were acting pursuant to their contractual authority in agreeing to sell the partnership assets, we find no merit whatever in appellants' contention that such sale constituted criminal wrongdoing. See *Fershtman v. Scheckman*, 450 F. 2d 1357, 1360 (2d Cir. 1971), *cert. denied*, 405 U.S. 1066 (1972). We find no support for this contention in appellants' allegation upon information and belief that, after appellees had agreed to sell to Bache, they were made aware that a principal of another brokerage firm "was prepared to negotiate the purchase of Bruns at a price that would match or exceed that offered by Bache", and that no appellee made any effort to ascertain whether the "offer" of that firm was superior to that of Bache. Of course, "prepared[ness] to negotiate" is not an "offer" to purchase. In view of the absolute and sole discretion vested in the Managing Directors and the preexisting sales agreement with Bache, this is a frivolous allegation of wrongdoing.

Equally frivolous is appellants' allegation that appellees were guilty of criminal conduct because they failed to promptly inform appellants that they would be

required to sign the written contract between Bruns and Bache. Although Bruns' Managing Directors had the undoubted authority to agree to the sale of the partnership assets, they had no power or authority to deliver their partners to Bache along with the assets. "A contract of employment cannot arise against the will or without the consent of an alleged party thereto." 56 C.J.S. *Master and Servant* §5 at 63; *Morgan v. Wheland Co.*, 66 F. Supp. 439, 440 (E.D. Tenn. 1946). Each Bruns partner and employee had the right to negotiate on his or her own behalf whether, and on what terms, he or she was willing to become associated with Bache.

We note that the partnership agreement required the Managing Directors to give the other partners notice of a proposed sale "not less than thirty (30) days prior to the effective date of the transaction." This was not a meaningless provision. *See Audino v. Lincoln First Bank*, 105 A.D. 2d 1091, 1093 (1984) (mem.), aff'd, 65 N.Y. 2d 631 (1985). Its obvious purpose was to give the other partners an opportunity to negotiate with Bache and to decide where their best interests lay. The contract between Bruns and Bache contains specific employment or compensation provisions, not only for the six appellees but also for four of the plaintiffs, two of whom are appellants. These provisions for the four plaintiffs would be meaningless if plaintiffs did not personally assent thereto, and, as experienced businessmen, plaintiffs surely knew that. Indeed, the contract provisions for salaries was expressly conditioned upon the recipients' agreement to become employees of Bache.

We note also that several of the partners, including plaintiffs Alvin Katz and Robert C. Stamm, were members of stock exchanges, and under the terms of the partnership agreement they had to determine what disposition was to be made of those memberships. Although

the Bache contract provided for transfer of exchange memberships, this obviously could not be accomplished without the concurrence of individual members.

Even if we accept appellants' implicit contention that they lacked sufficient sophistication to know that they could not be bonded over to Bache without their consent, they make no allegation of anything that prevented them on July 23 from refusing to sign the Bache contract unless they received more favorable personal treatment. Indeed, appellants were in as good, if not better, position to demand more favorable treatment on July 23 than they were a month earlier. At this stage of the proceedings, there certainly was more pressure on the parties to complete the transaction than there was at the outset of negotiations. Moreover, the written contract specifically provided that it could be amended or supplemented if the parties decided that such amendment was "necessary, desirable or expedient ... to facilitate ... the consummation of the transactions contemplated hereby." Appellants' contention that their signatures were coerced by criminal conduct on the part of appellees and that they were "forced to accept employment" on unfavorable terms is too conclusory to support a charge of criminal wrongdoing.

Assuming for the argument that appellants have spelled out some form of criminal fraud on appellees' part, they have not alleged a pattern of racketeering activity conducted in the affairs of an "enterprise". In *Sedima, supra*, 473 U.S. 479, 496 n. 14, the Court held that in order for there to be a pattern of racketeering activity, there must be continuing activity or continuity in the conduct at issue. There, the Court was concerned whether there was sufficient continuity and relatedness in the allegedly wrongful acts that they could be said to constitute a pattern. In *United States v. Weisman*, 624 F. 2d

1118 (2d Cir.), *cert. denied*, 449 U.S. 871 (1980), and again in *United States v. Ianniello, supra*, 808 F. 2d 184, this Court faced the question whether RICO also requires continuity and relatedness in the alleged "enterprise". We answered this question in the affirmative:

As discussed above, we believe that the inquiry as to relatedness and continuity is best addressed in the context of the concept of "enterprise" expressed in section 1962(c), and to a lesser extent, the ten year requirement of section 1961(5). An enterprise is "a group of persons associated together for a common purpose of engaging in a course of conduct" and "is proved by evidence of an ongoing organization, formal or informal, and by evidence that the various associates function as a continuing unit." *United States v. Turkette*, 452 U.S. 576, 583, 101 S. Ct. 2524, 2528, 69 L. Ed. 2d 246 (1981). This circuit requires that, under section 1962(c), the enterprise be a continuing operation and that the acts be related to the common purpose.

Ianniello, supra, 808 F. 2d at 191; *see also Beck v. Manufacturers Hanover Trust Co.*, 820 F. 2d 46, 51-52 (2d Cir. 1987).

Appellants contend that the Bruns partnership was the "enterprise" required by RICO, but assert in the same breath that the partnership was dissolved by the sale to Bache on August 7, 1981. Moreover, the very acts of which appellants complain were part of the dissolution process. Although, at first blush, the mere existence of a partnership entity would seem to satisfy the requirement of "enterprise", *see* 28 U.S.C. §1961(4), if an inquiry as to the necessary elements of continuity and relatedness is directed at the enterprise, then just being a partnership is not enough. The statute says that "enterprise" includes

partnerships, corporations, etc.; it does not say that all these entities always must be considered to be "enterprises". The existence of an enterprise "is proved by evidence of an *ongoing* organization, formal or informal, and by evidence that the various associates function as a *continuing unit*." *United States v. Turkette, supra*, 452 U.S. at 583 (emphasis supplied). According to appellants' complaint, at the time the allegedly wrongful acts occurred, the Bruns partners were not functioning as a continuing unit in an ongoing organization. Instead, the Bruns Managing Directors were said to be acting solely on their own to prevent the alleged enterprise from being an ongoing, continuing unit. While appellees' conduct need not have been in furtherance of the partnership affairs in order to bring their acts within the ban of RICO, *United States v. LeRoy*, 687 F. 2d 610, 616-17 (2d Cir. 1982), *cert. denied*, 459 U.S. 1174 (1983), since the effect of their acts was to remove Bruns from the very definition of enterprise, the requirement of continuity was not satisfied. We need not determine whether any basis other than RICO exists on which liability might be properly alleged. We simply conclude that a RICO violation has not been adequately pleaded.

The instant case is a paradigmatic example of the unfairness that results when RICO, a statute intended to be an "assault upon organized crime and its economic roots", *Russello v. United States*, 464 U.S. 16, 26 (1983), is used in an attempt to make a "federal case" of a simple falling out between partners. Giving appellants the benefit of every doubt, we conclude they have not succeeded in their attempt. For all of the foregoing reasons, the judgment of the district court is affirmed.

PRATT, *Circuit Judge*, dissenting:

I respectfully dissent. Not only does the majority fail

to assume the facts are as plaintiffs allege them to be, as is required on a motion to dismiss, but it compounds this error by making determinations that are directly contrary to those of the district court and of a unanimous panel of this court on the prior appeal in this case, *Furman v. Cirrito*, 741 F. 2d 524 (2d Cir. 1984) ("Furman I"), vacated and remanded, 105 S. Ct. 3550 (1985), on remand, 779 F. 2d 36 (2d Cir. 1985). Moreover, the majority fails to heed recent circuit precedent that should control this appeal, *United States v. Ianniello*, 808 F. 2d 184 (2d Cir. 1986) cert. denied, U.S.L.W. 3853 (June 23, 1987). As the concluding paragraph of the majority's opinion explicitly illustrates, this case now stands next in a long line of judicial attempts to construe narrowly RICO despite congress's express mandate that it should "be liberally construed to effectuate its remedial purpose." Pub. L. 91-452, §904(a), 84 Stat. 947. See *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, ____ 105 S. Ct. 3275, 3286 (1985).

The district court here found only that there was no "pattern" to defendants' racketeering activity. The basis of that conclusion—that *Sedima*'s footnote 14 altered the law governing racketeering patterns and that multiple fraudulent episodes are required—was eliminated by *Ianniello*. In affirming the district court, the majority relies on alternative grounds, neither of which was raised or addressed by the parties, and neither of which is supported by the law or the alleged facts. If this case were to be decided on the issues addressed by the district court and argued by the parties, *Ianniello* would require reversal. Since it is, instead, being decided by the majority's conclusions that no racketeering activity has been alleged and that there was no "enterprise", I can only dissent.

A. *The Presence of Alleged Racketeering Activity*

It is required on a motion to dismiss a complaint to

treat as true plaintiff's factual allegations, *Fifth Avenue Peace Parade Comm. v. Gray*, 480 F. 2d 326, 331 (2d Cir. 1973) (on "a motion to dismiss on the pleadings, the allegations of the complaint ... had to be accepted as true"), and to dismiss only if "it appears beyond doubt that plaintiff can prove no set of facts in support of his claim which would entitle him to relief", *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). The majority, however, finds it difficult to hold to these fundamentals, variously characterizing plaintiffs' allegations as 'border[ing] on the specious', "frivolous", and "conclusory". When a proper lens is used to view plaintiffs' complaint, however, a far different picture emerges.

Plaintiffs allege that the sale of the Bruns partnership was accomplished by means of fraudulent concealment of material information (the fact that without plaintiffs' signatures on the sales agreement Bache would not proceed with the sale) in violation of the partnership agreement, which, as the majority concedes, required the managing directors to give notice of a proposed sale to their partners "not less than thirty (30) days prior to the effective date of the transaction". Moreover, plaintiffs allege, in reaching the sales agreement, several of the defendants accepted pay-offs that induced them to agree to the terms negotiated by the managing directors, even though terms more favorable to the partnership were obtainable.

Rather than taking these allegations as true, the court states that it has "carefully reviewed the complaint, in light of the undisputed documents, in an attempt to understand how appellants are attempting to meet their obligation to allege statutorily required charges of criminal wrongdoing." With all due respect, the majority in actuality holds that plaintiffs have failed to justify their charges, rather than to allege the wrongdoing necessary

in a RICO complaint. Nevertheless, the majority is forced to concede that the district court did not view this motion to dismiss as one for summary judgment, and if it had, it would have been required by Fed. R. Civ. P. 12(b) to afford plaintiffs "reasonable opportunity to present all material made pertinent to such a motion by Rule 56." *See In re G. & A. Books, Inc.*, 770 F. 2d 288, 294-95 (2d Cir. 1985) ("[t]he essential inquiry is whether the appellant should reasonably have recognized that the motion might be converted into one for summary judgment or was taken by surprise"). Even if the majority is correct that "the district court might have treated the motion as one for summary judgment", it surely was not error that it did not, and given that it did not, plaintiffs could not have foreseen that this court on appeal suddenly would do so, especially since the defendants made clear in the motion itself that "[f]or our motion to dismiss, we rely on the law" rather than on the facts, and since defendants recognize in their brief on appeal, "Because this is an appeal from dismissal of the complaint, we must accept the allegations of the complaint as true."

But even if we assume that defendants did not violate the notice requirement, the weight the majority places on the managing directors' contractual authority to dispose of the partnership assets "in their sole discretion" is unjustified. The majority says, "Since appellees were acting pursuant to their contractual authority in agreeing to sell the partnership assets, we find no merit whatever in appellants' contention that such sale constituted criminal wrongdoing." The majority points out that under New York law, "[e]ven terms which permit self-dealing by a partner will be enforced"; but the case cited for that proposition, *Riviera Congress Assocs. v. Yassky*, 18 N.Y. 2d 540, 548-49, 277 N.Y.S. 2d 386, 392-93 (1966), holds only that when partners are "fully apprised" that their fellow partners intend to engage in self-dealing, such appraisal

"has the effect of 'exonerating' the [self-dealing partners], ... from adverse inferences that might otherwise be drawn against them simply from the fact that they dealt with themselves." *Id.* at 548 (citation omitted). Nothing in *Yassky*, or in other New York law, permits partners to self-deal and conceal it from their partners.

The majority relies primarily on paragraph 37 of the Bruns partnership agreement, which provides:

The Managing Directors, by unanimous vote, shall have full power and authority on behalf of all the partners, at any time, to sell or otherwise transfer all or substantially all of [the] assets and business of the partnership, on such terms and conditions as the Managing Directors, in their sole discretion, may approve, provided that notice in writing of such proposed transaction shall be given to all of the partners not less than thirty (30) days prior to the effective date of the transaction.

They point out that under paragraph 37, "Although Bruns' Managing Directors had the undoubted authority to agree to the sale of the partnership assets, they had no power or authority to deliver their partners to Bache along with the assets. ... Each Bruns partner and employee had the right to negotiate on his or her own behalf whether, and on what terms, he or she was willing to become associated with Bache."

In other words, according to the majority, each of the plaintiffs could have negotiated for better terms of his employment or, if not satisfied, could have opted out of the deal and obtained employment elsewhere. Plaintiffs, however, allege, in paragraph 12 of the complaint, that "Bache would not complete the contemplated transaction with Bruns unless and until each and every one of the

general partners of Bruns consented to the transaction and evidenced that consent by signing the Purchase Agreement. However, none of the plaintiffs were informed that Bache was insisting upon their consents."

Assuming, as we must, that this is true, its significance becomes paramount because each one of the plaintiffs could, by refusing to sign up, have done far more than simply "opted out" of joining Bache; they could have instead killed the entire deal and along with it the "sweet-heart" contracts that defendants had negotiated for themselves. Defendants thus concealed from plaintiffs the extent of the power that Bache's negotiating position had conferred on each of them.

Nowhere does the majority mention this crucial allegation, nor does it give any reason why paragraph 37 justifies defendants' self-dealing and fraud in concealing from plaintiffs the full picture of the conditions demanded by Bache. Paragraph 37 does not, clearly and unambiguously, authorize defendants to withhold from their partners crucial parts of the deal. At the very least then, if that paragraph is to be construed as permitting this unusual kind of self-dealing and concealment thereof, and as overriding the normal tenet of partnership law that partners owe to one another a fiduciary duty of the "utmost good faith, fairness, [and] loyalty", *Newburger, Loeb & Co., Inc. v. Gross*, 563 F.2d 1057, 1078 (2d Cir. 1977), quoting Crane and Bromberg, *Law of Partnership*, §68, at 390 (1968); *see also* N.Y. Partnership Law §43(1) (McKinney 1948); *Meinhard v. Salmon*, 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (Cardozo, Ch.J.) ("[A] trustee is held to something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior."), such a conclusion should be reached only after a finder of fact has so construed it, based on extrinsic evidence

showing additional circumstances not apparent on the face of the agreement.

Until and unless congress changes RICO, mail and wire fraud are as much predicate acts of racketeering activity as murder and blackmail. As judges we have no right effectively to remove from RICO two crimes, mail fraud and wire fraud, that congress has decreed are among the hallmarks of racketeers. The majority seeks to distinguish fraud from other racketeering activity by saying, "We have, we believe, made it clear that we look with a jaundiced eye upon allegations of fraud based on information and belief." The apparent basis for this statement is Fed. R. Civ. P. 9(b): "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." *See Luce v. Edelstein*, 802 F. 2d 49, 54 n. 1 (2d Cir. 1986); *Decker v. Massey-Ferguson, Ltd.*, 681 F. 2d 111, 114 (2d Cir. 1982). But rule 9(b) requires only that "a complaint 'must allege with some specificity the acts constituting the fraud'", *id.*, quoting *Rodman v. Grant Foundation*, 608 F. 2d 64, 73 (2d Cir. 1979). Obviously, there is no violation of rule 9(b) here, since plaintiffs have specifically pinpointed the acts and circumstances they allege were fraudulent, and since the district court did not find, nor do defendants allege, any failure to comply with the rule. Instead, the majority extrapolates from the rule a "jaundiced eye" with which to regard allegations of fraud, even when made in compliance with the rule. I see no basis on a rule 12(b)(6) motion for the majority to reject properly pled allegations of fraud, even ones "based upon information and belief", *see Schlick v. Penn-Dixie Corp.*, 507 F. 2d 374, 379 (2d Cir. 1974) ("While all of [the] allegations are stated on information and belief, ... the particularity requirement may be satisfied if, as here, the allegations are accompanied by a statement of the facts upon which the belief is founded.")

The majority does not merely refuse to assume the truth of plaintiffs' well-pled allegations of fraud; what it really does is decide the fraud against them. The proper time and place to decide that issue, however, is at trial, and not on a rule 12(b)(6) motion.

The court says that it has "difficulty in discovering a sufficient allegation of any racketeering activity at all." That may be true, but I feel constrained to point out that the district court in this case—twice—had no trouble whatever finding a sufficient allegation of racketeering activity in plaintiffs' complaint, the first time when it dismissed as "semantical strawmen" defendants' arguments that no pattern of racketeering activity had been alleged, *Furman v. Cirrito*, 578 F. Supp. 1535, 1538 (S.D.N.Y. 1984) ("[C]learly, a 'pattern of racketeering activity' is alleged as 2 or more acts of wire and mail fraud have been alleged."), *aff'd*, 741 F. 2d 524 (2d Cir. 1984), *rev'd and remanded on reconsideration*, 779 F. 2d 36 (2d Cir. 1985), and the second time when it decided, in granting the judgment on appeal here, that plaintiffs had failed to allege a pattern. As Judge Cooper put it, "[W]e do not hesitate to conclude ... that the complaint alleges defendants engaged in racketeering activity since they used the mails and telephone in furtherance of a scheme to defraud. Thus, the only question remaining is whether such activity formed a 'pattern.'" *Furman v. Cirrito*, No. 82 Civ. 4428 (S.D.N.Y. March 12, 1986).

Moreover, the racketeering activity alleged in this complaint was apparent not only to the district court. In *Furman I*, a unanimous panel of this court, reviewing the same complaint, reached the following conclusion on the same allegations:

[I]t is apparent that plaintiffs have sufficiently alleged those facts required by the statutory

language The alleged pattern of racketeering activity was repeated use of the mails and the wires, in furtherance of defendants' underlying scheme to defraud plaintiffs by concealing from them ... the true conditions for the sale of Bruins.

Furman I, 741 F. 2d at 527. It seems somewhat strange that four federal judges could find sufficient allegations of racketeering activity in the complaint that the court today is able to dismiss, before an answer to the complaint has even been filed, for lack of such allegations.

B. *The Presence of a Racketeering Pattern.*

Since the majority concludes that plaintiffs have failed to allege any racketeering activity, they never come to grips with the only issue raised and briefed by the parties, the content of the RICO requirement that there be a "pattern" of such activity. Since I would conclude that plaintiffs have alleged racketeering activity, I would reach the further issue of the pattern requirement, and would reverse the judgment of the district court on the strength of our recent decision in *Ianniello*.

In a nutshell, this is the situation: In *Furman I*, this court determined that plaintiffs alleged a pattern of racketeering activity. On remand, the district court, believing that the intervening Supreme Court decision in *Sedima* had altered the law on the pattern requirement, decided that no pattern was alleged. After that, however, this court held in *Ianniello* that *Sedima* had not altered the law applied in *Furman I*. From this, I can conclude only that *Ianniello* undercuts completely the basis for the district court's decision. Obviously, the majority disagrees. Hence, a more complete discussion of *Sedima* and *Ianniello* is necessary.

The core of the controversy surrounding footnote 14 of *Sedima* is what the Court meant by "continuity" and "relatedness", which it indicated were necessary elements of a "pattern" of racketeering activity. The meaning of footnote 14 has divided the courts that have considered it, *see, e.g., Northern Trust Bank/O'Hare, N.A. v. Inryco, Inc.*, 615 F. Supp. 828, 833 (N.D. Ill. 1985) (*Sedima* created a "whole new ballgame"); *Bank of America National Trust & Savings Assn. v. Touche Ross & Co.*, 782 F. 2d 966, 971 (11th Cir. 1986) (nine predicate acts all part of one scheme satisfy pattern requirement after *Sedima*), but *Ianniello* settles its meaning for our circuit: any necessary "continuity" and "relatedness" are to be found not in "pattern", but in the concept of "enterprise", 18 U.S.C. §1962(c), and in the requirement that the predicate acts take place within a ten-year period, 18 U.S.C. §1961(5). *Ianniello*, 808 F. 2d at 190. *See also United States v. Weisman*, 624 F. 2d 1118, 1122 (2d Cir. 1980).

The majority seeks to distinguish *Ianniello* by finding an absence of an "enterprise" here because the enterprise that might satisfy the pattern requirement—the Bruns partnership itself—was dissolved by the very acts alleged by plaintiffs to have amounted to racketeering. This novel theory, which was never even suggested by defendants or briefed by either side, ignores the simple fact that the dissolution of Bruns occurred as a result of—and after—the fraud took place. The fact that defendants' scheme was successful in putting an end to the enterprise surely should not insulate the schemers from RICO liability. In cases where the purpose of the racketeering activity is to put an end to the enterprise and to profit thereby, there is no reason to believe that congress intended to leave the injury unremedied. It would be anomalous to allow these defendants to escape RICO liability simply because their racketeering activity was successful in achieving its intended result: termination of

the enterprise.

The majority further resists the conclusion that the Bruns partnership was itself the RICO enterprise by implying that defendants' actions were somehow not in the conduct of the enterprise's affairs, a position that, of course, is inherently inconsistent with their earlier conclusion that the partnership agreement authorized defendants to do what they did. The majority says, "[A]t the time allegedly wrongful acts occurred, the Bruns partners were not functioning as a continuing unit in an ongoing organization. Instead, the Bruns Managing Directors were said to be acting solely on their own to prevent the alleged enterprise from being an ongoing, continuing unit." Yet, §1962(c) of RICO provides:

It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate, or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

18 U.S.C. §1962(c) (emphasis added). To conclude as the majority apparently does that the sale of the partnership is not "in the conduct of such enterprise's affairs" is surprising, to say the least. That defendants were self-dealing in the conduct of Bruns' affairs does not make their actions any less "in the conduct of [Bruns'] affairs"; what it does do is make their self-dealing, their concealment of it, and their use of the mails in furtherance of it, racketeering.

While the majority here motors past *Ianniello* with hardly a glance in the rear view mirror, another panel's recent opinion in *Beck v. Manufacturers Hanover Trust Co.*,

820 F. 2d 46 (2d Cir. 1987), rides right over it. There the court acknowledged that *Ianniello* rejects any requirement of multiple episodes to allege a "pattern of racketeering activity"; in the next breath, however, it brought the multiple-episode concept back to life by engrafting it onto the "enterprise" requirement. The *Beck* court defined "enterprise" as the racketeering episode allegedly engaged in by the defendants, rather than as what the statute describes: the organizational vehicle by or through which the racketeering activity is undertaken. See *United States v. Turkette*, 452 U.S. 576, 583 (1981) ("The 'enterprise' is not the 'pattern of racketeering activity'; it is an entity separate and apart from the pattern of activity in which it engages."). RICO's plain language makes it improper to conflate "continuing enterprise" and "racketeering activity". By equating "enterprise" with "racketeering activity" and then requiring multiple episodes in order to make the enterprise a "continuing enterprise" *Beck* appears to defer to the authority of *Ianniello*. Realistically, however, *Beck* undercuts *Ianniello* by putting back into the RICO stew the multiple-episode ingredient that *Ianniello* sought to remove.

Such conflict between decisions of this court issued seven months apart, along with the additional confusion that surely will be generated by today's decision, cannot help but make worse what can only be described as a "mess" in the RICO decisions of our district courts. For convenience, I will refer to the following decisions as either "pre-" or "post-*Ianniello*" and as either in agreement with *Ianniello*'s broad reading of pattern or as restricting the term.

Andre v. Friedlander, 660 F. Supp. 1362, 1369-70 (D. Conn. 1987)
(Blumenfeld, J.) (post-*Ianniello* and applying it);
In re Gas Reclamation, Inc. Securities Litigation, 659 F.

Supp. 493, 514-15 (S.D.N.Y. 1987)
(Sand, J.) (post-*Ianniello* and applying it, but reversing earlier, contrary position of Judge Sand); *Siegel v. Tucker*, 658 F. Supp. 550, 554-55 (S.D.N.Y. 1987)
(Kram, J.) (post-*Ianniello* but not mentioning it and restricting "pattern"); *City of New York v. Joseph L. Balkan, Inc.*, 656 F. Supp. 536, 544-45 (E.D.N.Y. 1987)
(Nickerson, J.) (post-*Ianniello* and applying it); *United States v. Weinberg*, 656 F. Supp. 1020, 1024-25 (E.D.N.Y. 1987)
(McLaughlin, J.) (post-*Ianniello* and applying it); *Continental Health Industries, Inc. v. Franklin & Joseph, Inc.*, No. 85 Civ. 8756 (S.D.N.Y. March 18, 1987)
(Carter, J.) (post-*Ianniello* but nevertheless restricting "pattern" by limiting *Ianniello* to criminal RICO); *Procter & Gamble Co. v. Big Apple Industrial Buildings, Inc.*, 655 F. Supp. 1179, 1182-84 (S.D.N.Y. 1987)
(Leval, J.) (same as *Continental Health Industries*); *Corcoran v. American Plan Corp.*, No. CV 86-1729 (E.D.N.Y. Feb. 6, 1987)
(Sifton, J.) (post-*Ianniello* and applying it); *Shopping Mall Investors, N.V. v. E.G. Frances & Co., Inc.*, No. 84 Civ. 1469 (S.D.N.Y. January 30, 1987)
(Keenan, J.) (post-*Ianniello* but nevertheless restricting "pattern" by limiting *Ianniello* to criminal RICO); *State of New York v. O'Hara*, 652 F. Supp. 1049, 1052-53 (W.D.N.Y. 1987)
(Curtin, Ch. J.) (post-*Ianniello* and applying it, reversing earlier, contrary position of Judge Curtin); *Cefali v. Buffalo Brass Co., Inc.*, 653 F. Supp. 263, 265-66 (W.D.N.Y. 1986)

(Curtin, Ch. J.) (pre-*Ianniello* and disagreeing with it; abandoned by Judge Curtin in *O'Hara, supra*); *Gerson v. Rapoport*, 651 F. Supp. 395, 397-99 (N.D.N.Y. 1987)

(McAvoy, J.) (post-*Ianniello* and applying it); *Bankers Trust Co. v. Feldesman*, 648 F. Supp. 17, 24-27 (S.D.N.Y. 1986)

(Conner, J.) (pre-*Ianniello* and agreeing with its broad construction of "pattern"); *Baum v. Phillips, Appel & Walden Inc.*, 648 F. Supp. 1518, 1533-35 (S.D.N.Y. 1986)

(Leisure, J.) (pre-*Ianniello* and disagreeing with it); *Kovian v. Fulton County National Bank and Trust Co.*, 647 F. Supp. 830, 837-38 (N.D.N.Y. 1986)

(Munson, Ch. J.) (pre-*Ianniello* and disagreeing with it); *Carlucci v. Owens-Corning Fiberglass Corp.*, 646 F. Supp. 1486 (E.D.N.Y. 1986)

(Wexler, J.) (pre-*Ianniello* and disagreeing with it); *Beck v. Manufacturers Hanover Trust Co.*, 645 F. Supp. 675, 683-85 (S.D.N.Y. 1986), *aff'd on other grounds*, 820 F. 2d 46 (2d Cir. 1987)

(Sweet, J.) (pre-*Ianniello* and disagreeing with it); *Bear Creek Productions Inc. v. Saleh*, 643 F. Supp. 489 (S.D.N.Y. 1986)

(Weinfeld, J.) (pre-*Ianniello* and disagreeing with it); *Schaafsma v. Marriner*, 641 F. Supp. 576 (D. Vt. 1986)

(Billings, J.) (pre-*Ianniello* and disagreeing with it); *Richter v. Sudman*, 634 F. Supp. 234, 238-40 (S.D.N.Y. 1986)

(Goettel, J.) (pre-*Ianniello* and disagreeing with it); *Soper v. Simmons International, Ltd.*, 632 F. Supp. 244, 250-55 (S.D.N.Y. 1986)

(Sand, J.) (pre-*Ianniello* and disagreeing with it; found by Judge Sand in *In re Gas Reclamation, Inc., supra*, to be rejected by *Ianniello*);

Anisfeld v. Cantor Fitzgerald & Co., Inc., 631 F. Supp. 1461, 1467 (S.D.N.Y. 1986)

(Pollack, J.) (pre-*Ianniello* and disagreeing with it);
T. & S. Commodities, Inc. v. Becharas Bros. Coffee Co., No. 86 Civ. 0070 (S.D.N.Y. Oct. 6, 1986)

(Owen, J.) (pre-*Ianniello* and disagreeing with it);
James A. Jennings Co., Inc. v. Calgi, No. 85 Civ. 8787 (S.D.N.Y. Sept. 22, 1986)

(Motley, Ch. J.) (pre-*Ianniello* and agreeing with it);
Conan Properties, Inc. v. Mattel, Inc., 619 F. Supp. 1167, 1171 (S.D.N.Y. 1985)

(Duffy, J.) (pre-*Ianniello* and agreeing with it);

I apologize to any of my district court colleagues whose contribution to this judicial cacophony I may have overlooked. But the point is clear: the contest of the "pattern" requirement is a point of sharp division, even after *Ianniello*, which one would have hoped had settled the issue. *Beck*, of course, is virtually certain to turn this mild chaos into sheer bedlam.

Even in the short time since *Beck* was decided, in fact, this bedlam has begun to emerge, as several district judges have wrestled with the contradictions between this court's precedents. See *Nassau-Suffolk Ice Cream, Inc. v. Integrated Resources, Inc.*, 662 F. Supp. 1499 (S.D.N.Y. 1987) (Pollack, J.) (interpreting *Beck* as supporting a "narrow" reading of *Ianniello*, and characterizing the "controlling Second Circuit precedents" as "not totally in unison"), *Guilford Mills v. Torf*, No. 85 Civ. 9473 (S.D.N.Y. June 4, 1987) (Haight, J.) (restricting "pattern" by interpreting *Ianniello* narrowly in light of *Beck*); *Goldman v. McMahon, Brafman, Morgan & Co.*, No. 85-2236 (S.D.N.Y. June 17, 1987), and *Solitron Inc. v. McAngus*, No. 86-0486 (S.D.N.Y. June 11, 1987) (Leisure, J.) (adopting *Ianniello*'s broad reading of pattern and concluding that *Beck* did not narrow *Ianniello*). Obviously, nothing is clear in this area

except the obvious need for definitive and decisive direction from this court, direction that the majority fails to provide.

I would reach the "pattern" issue, and decide it simply on the authority of *Ianniello*, rejecting the distinction between civil and criminal RICO offered by some district judges (but not raised here) as contrary to *Sedima*'s teaching that civil RICO, as well as criminal RICO, is to be broadly construed. 105 S. Ct. at 3286. Because the majority does not even reach this issue, but instead decides this case on grounds not raised by the parties and not, in my view, justified by the law, I dissent.

APPENDIX I

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT IN *TELEVIDEO SYSTEMS V. HEIDENTHAL, NO. 86-2129* SLIP OP. (9TH CIR. SEPTEMBER 2, 1987)

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

(Argued and Submitted March 10, 1987,
Decided September 2, 1987.)
Docket No. 86-2129

TELEVIDEO SYSTEMS, INC., K. PHILIP
HWANG, C. GEMMA HWANG,
Plaintiffs-Appellees,

-v.-

FRED. P. HEIDENTHAL, Individually and
d/b/a South Harbor Investors and West Cliff
Securities,
Defendant-Appellant.

Before:
FLETCHER, BEEZER and THOMPSON,
Circuit Judges.

Defendant appealed from an order of the United States District Court for the Northern District of California, William A. Ingram, J., which entered default judgment after striking his answer. The Court of Appeals held that: (1) court did not abuse its discretion in striking answer and entering default judgment against defendant

as sanction for perjury during depositions and false pleadings filed with court, and (2) plaintiffs made adequate showing of pattern of racketeering activity. Affirmed.

JOHN S. SIAMAS, Debra S. Belaga and Joseph S. Faber, San Francisco, Cal., for plaintiff TeleVideo Systems, Inc. ALLEN RUBY, San Jose, Cal., for plaintiffs-appellees. DAVID VAN HOESEN, San Francisco, Cal. for defendant-appellant.

PER CURIAM:

Appellant, Fred Heidenthal, appeals a default judgment entered against him as a sanction for his perjury during depositions and the false pleadings he filed with the court. The district court struck his answer and allowed the appellees to proceed with proof of their case unopposed. The court entered a judgment in excess of \$11,000,000 for securities fraud and violations of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §§1961 *et seq.* (RICO). We affirm.

FACTS

TeleVideo Systems, Inc. and its principal shareholders brought suit against Heidenthal, a vice-president of the company, for securities fraud and RICO violations after discovering evidence of his substantial fraudulent activities. Heidenthal allegedly participated in the diversion of company funds to several fictitious businesses that he had "created."

In depositions, Heidenthal did not deny orchestrating the diversion of corporate funds. Rather, he claimed that he acted at the behest of Mr. Hwang, the President of TeleVideo, to divert money from TeleVideo for Mr.

Hwang's personal use. Heidenthal testified extensively and in great detail about a pseudo-gambling scheme (playing both sides of a bet) that he used as a vehicle to accomplish the diversion, and about other secret transfers of cash to Hwang. Much of the energy of appellees in preparing their case for trial necessarily was diverted to disproving these allegations.

On the day of trial, Heidenthal appeared in court and filed a written declaration that he had testified falsely in his depositions. Specifically, he admitted that he had not participated in a pseudo-gambling scheme but rather had lost \$700,000 of appellees' money in gambling. He also stated that he did not transfer large sums of cash to Hwang. Appellees filed a motion for sanctions and for default judgment on their claims against Heidenthal. The court granted appellees' motion for sanctions. It struck Heidenthal's answer and then proceeded to hear appellees' proof in support of their claims against Heidenthal. At the conclusion of the hearing, the court awarded appellees \$3,427,392.60 in actual damages together with \$766,630.31 in attorneys fees. It directed that the damage award be trebled and that all stock in TeleVideo acquired by Heidenthal be restored to TeleVideo and that the stock purchase agreement between TeleVideo and Heidenthal be rescinded.

DISCUSSION

I

(1) (2) Appellant claims that the district court abused its discretion in striking his answer and entering a default judgment against him. We disagree. Courts have inherent equitable powers to dismiss actions or enter default judgments for failure to prosecute, contempt of court, or abusive litigation practices. *See Roadway Express, Inc. v.*

Piper, 447 U.S. 752, 764, 100 S. Ct. 2455, 2463, 65 L. Ed. 2d 488 (1980); *Link v. Wabash R.R.*, 370 U.S. 626, 632, 82 S. Ct. 1386, 632, 8 L. Ed. 2d 734 (1962); *United States v. Moss-American, Inc.*, 78 F.R.D. 214, 216 (E.D. Wis. 1978). Although the inherent powers have been criticized as "nebulous" *see Eash v. Riggins Trucking, Inc.*, 757 F. 2d 557, 561 (3d Cir. 1985), they are necessary to enable the judiciary to function. *See Michaelson v. United States*, 266 U.S. 42, 65, 45 S. Ct. 18, 19, 69 L. Ed. 162 (1924) (recognizing the inherent power of the courts to punish for contempts as essential to the administration of justice).

(3) There are limits, however, on the power of courts to impose sanctions. The need for the orderly administration of justice does not permit violations of due process. *See Phoceene Sous Marine, S.A. v. U.S. Phosmarine, Inc.*, 682 F. 2d 802, 805-06 (9th Cir. 1982) (recognizing that willful deceit and conduct utterly inconsistent with the orderly administration of justice would merit the imposition of severe sanctions, but finding that because defendant's deceit—falsely stating that he was too ill to attend trial—was unrelated to the merits of the controversy the sanction was inconsistent with due process); *Securities and Exchange Commission v. Seaboard Corp.*, 666 F. 2d 414, 416-17 (9th Cir. 1982) (finding that a default judgment against the defendant for failure to pay a fine when the defendant had complied with an order to give a deposition was punitive and a violation of due process as the court could not presume that the case lacked merit); *see also Hammond Packing Co. v. Arkansas*, 212 U.S. 322, 349-54, 29 S. Ct. 370, 379-81, 53 L. Ed. 530 (1909) (upholding a default judgment for the defendant's failure to comply with an order to produce documents because the court could presume, from the failure to produce evidence relating directly to the merits of the matter, that the case was lacking in merit); *Hovey v. Elliott*, 167 U.S. 409, 413-14, 17 S. Ct. 841, 843, 42 L. Ed. 215 (1897) (finding that courts may not strike

an answer and enter a default merely to punish a contempt of court unrelated to the merits of the case).

Appellant's elaborate scheme involving perjury clearly qualifies as a willful deceit of the court. Although the perjury occurred before the trial began, it infected all of the pretrial procedures and interfered egregiously with the court's administration of justice. The court sanctioned Heidenthal not only to punish him, but to enable the court to proceed to hear and decide the case untainted by further interference and possible further perjury on the part of Heidenthal.

Appellant argues that a default judgment of this magnitude was far too severe a penalty. He argues that he mitigated the harm by admitting before trial commenced that he had perjured himself; he urges that his confession warrants some favorable consideration and argues that this court should be lenient towards him in order not to deter future perjurers from making such admissions. In other words, appellant believes that his belated candor should be rewarded. In some circumstances we might agree that lesser sanctions would be appropriate where a defendant has admitted his falsehoods and they have not tainted the entire pretrial process. This is not such a case.

Appellant's recantation was not motivated by a desire to repent and set the record straight. Under questioning by the district judge, appellant revealed that even his admission was part of his elaborate scheme to prevail at trial. In answer to the district judge's question as to why he testified falsely in the depositions, appellant responded:

"[b]ecause I was making sure that I would have him and Phil (Hwang) to the point where they thought they had me by the

short ones, and they would get me in here and then, when I got in here, I am going straight and tell the truth on everything, and his case is going to crumble apart."

Heidenthal's statement, perhaps the only candid one he makes, reveals that his perjury and the recanting were both orchestrated to reap a tactical advantage. To permit Heidenthal to proceed to trial would have played into Heidenthal's hands and greatly disadvantaged plaintiffs who had planned their strategy and developed their case to respond to Heidenthal's false evidence.

(4) Under the circumstances, the trial court accorded Heidenthal all the process that was his due. The court, proceeding under Rule 55(b)(2) of the Federal Rules of Civil Procedure, determined that a hearing should be held and that the plaintiffs should present in open court their *prima facie* case showing entitlement to judgment. At the hearing, the court heard substantial testimony and admitted documentary evidence on all of the plaintiffs' claims. Plaintiffs, as part of their presentation, furnished the court with an extensive memorandum that, *inter alia*, cited the court to the specific exhibits among the voluminous submissions that would support each of their claims. At the conclusion of the hearing the court stated that it was satisfied with proof on all claims with one caveat that it wished to give further consideration to the "RICO case," although it expressed the view that "there is little problem with it." (TR 140). Subsequently, it entered judgment for the plaintiffs on all claims.

Rule 55 gives the court considerable leeway as to what it may require as a prerequisite to the entry of a default

judgment.¹ "The general rule of law is that upon default the factual allegations of the complaint, except those relating to the amount of damages, will be taken as true." (Citations omitted). *Geddes v. United Financial Group*, 559 F. 2d 557, 560 (9th Cir. 1977). The district court exceeded the requirements of the rule by taking extensive evidence on all allegations in the complaint including damages.

In addition to claiming that it was error to enter a default judgment against him, Heidenthal claims, that, in any event, it was error to award damages against him on the RICO claims. Before the district court, he claimed that the court lacked jurisdiction over the RICO claims because of the deficiency in the pleadings in respect to the existence of a pattern of racketeering activity. On appeal, his contention is that there was no substantial evidence that he engaged in a pattern of racketeering activity. Ordinarily, in the context of a default, we would permit the appellant to challenge only the sufficiency of the allegations in the complaint to support the claims of RICO violations, *Danning v. Lavine*, 572 F. 2d 1386 (9th Cir. 1978), and, of course, the evidence in respect to damages. *Geddes*, 559 F. 2d at 560. However, since the court required the plaintiffs to prove a *prima facie* case, we have reviewed both the averments in the complaint and the evidence adduced at the hearing.

(5) In *Sedima S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 n. 14, 105 S. Ct. 3275, 3285 n. 14, 87 L. Ed. 2d 346 (1985), the

¹ Rule 55(b)(2) in pertinent part reads: "If, in order to enable the court to enter judgment or to carry it into effect, it is necessary to take an account or to determine the amount of damages or to establish the truth of any averment by evidence or to make an investigation of any other matter, the court may conduct such hearings or order such references as it deems necessary and proper ..."

Supreme Court cautioned that, while a "pattern of racketeering activity" must include at least two distinct acts of racketeering,

[t]he legislative history supports the view that two isolated acts of racketeering activity do not constitute a pattern. As the Senate Report explained: "The target of (RICO) is thus not sporadic activity. The infiltration of legitimate business normally requires more than one 'racketeering activity' and the threat of continuing activity to be effective. It is this factor of continuity plus relationship which combines to produce a pattern" S. Rep. No. 91-617, p. 158 (1969) (emphasis added).

Both TeleVideo's complaint and the evidence presented at the default hearing reveal that Heidenthal engaged in at least thirteen acts of fraud, clearly related, with similar purposes, results, participants, victims, and methods of commission. Because these acts were many, continuous and related, we have no difficulty concluding that a pattern of racketeering activity was pled and a *prima facie* case established.

AFFIRMED.

APPENDIX J

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT IN *ALLRIGHT MISSOURI V. BILLETER, NO. 86-1476,* SLIP OP. (8TH CIR. SEPTEMBER 16, 1987)

UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

(Submitted April 13, 1987,
Decided September 16, 1987)
Docket Nos. 86-1476, 86-1537

ALLRIGHT MISSOURI, a Missouri corporation, individually and on behalf of Downtown Development Associates, Ltd., a Missouri limited partnership,

Appellant,

-v.-

J. DAVID BILLETER, individually and as general partner of Downtown Development Associates, Ltd., a Missouri limited partnership; ROBERT BLUESTEIN, individually, and as general partner of Downtown Development Associates, Ltd.; JOSEPH E. BURKHARDT, individually, and as general partner of Downtown Development Associates, Ltd. and as general partner of Riverside Hotel Investment, Ltd., a Missouri limited partnership; BENJAMIN ICHINOSE, individually, and as general partner of Downtown Development Associates, Ltd., a Missouri limited

partnership; IRWIN SENTURIA, individually, and as general partner of Downtown Development Associates, Ltd., a Missouri limited partnership; RICHARD H. SENTURIA, individually, and as general partner of Downtown Development Associates, Ltd., a Missouri limited partnership, and as general partner of Riverside Hotel Investment, Ltd., a Missouri limited partnership; COMMNET FINANCIAL SERVICES, INC.; LAWRENCE E. KUDER, in his capacity as Trustee for Savings Investment Service Corporation; CLAYTON G. CARY, JR.; JOHN W. CARY; J. DENNIS CATALANO; RONALD H. FELL; RICHARD H. FENDELL; FIRST KING PROPERTIES, INC.; GAIL K. FISCHMANN; STEPHANIE FRIEDMANN; GUARANTEE ELECTRICAL CO.; ROBERT HANSON and IMOGENE HANSON; HOFFMAN PARTNERSHIP, INC.; E. DEAN JARBOE; JACK K. KRAUSE; DENNIS P. LONG; EUGENE V. RANKIN; SIMON INVESTMENT TRUST; T&M INVESTMENT, INC.; RICHARD S. WEISS; SANFORD W. WEISS; WHARFSIDE REDEVELOPMENT CORPORATION; THE RIVERSIDE AND LANDING PARKING SYSTEM, INC.; BURKHARDT FAMILY TRUST; ROBERT BLUESTEIN and DORA BLUESTEIN; RICHARD H. SENTURIA and ILENE B. SENTURIA,

Appellees.

Before:

LAY, *Chief Judge* and ARNOLD and

WOLLMAN, *Circuit Judges.*

WOLLMAN, Circuit Judge:

Allright Missouri, Inc. (Allright), a Missouri corporation, appeals from a final judgment entered by the district court dismissing its claims against the defendants. In addition, Allright also appeals several interlocutory orders decided adversely to it below. We affirm in part, reverse in part, and remand for further proceedings consistent with this opinion.

Allright is a limited partner in Downtown Development Associates, Ltd. (Downtown), a Missouri limited partnership formed by defendants Joseph Burkhardt and Richard Senturia in 1980 for the purpose of acquiring two city blocks of land located in an area known as Lacledes Landing in downtown St. Louis, Missouri. After the property was acquired, the general partners of Downtown¹ sold units of limited partnership interests in Downtown over the next three years to several individuals and entities.² Allright contends that material misrepresentations and omissions of fact were made in the sale of these interests.

¹ The general partners of Downtown, each of whom has been named as a defendant in this case, are Richard Senturia, Joseph Burkhardt, Irwin Senturia, J. David Billeter, Benjamin Ichinose, and Robert Bluestein.

² The limited partners of Downtown are Allright, Clayton Cary, Jr., John Cary, J. Dennis Catalano, Ronald Fell, Richard H. Fendell, First King Properties, Inc., Gail Fischmann, Stephanie Friedmann, Guarantee Electrical Company, Robert Hanson and Imogene Hanson, Hoffman Partnership, Inc., E. Dean Jarboe, Jack K. Krause, Eugene V. Rankin, Simon Investment Trust, T&M Investment, Inc., Richard Weiss, and Sanford Weiss. (Dennis Long had been a limited partner in Downtown but has subsequently renounced any interest he may have had as a limited partner in Downtown.)

In 1984, the general partners proposed a conveyance of approximately 1.3 acres of Downtown's real property to another Missouri limited partnership, Riverside Hotel Investments, Ltd. (Riverside), in exchange for a twenty percent interest in that partnership. Riverside planned to construct a three-hundred room, eight story hotel on the site. Pursuant to the Downtown limited partnership agreement, consent of the majority-in-interest of the limited partners was needed to convey the property to Riverside inasmuch as Burkhardt and Senturia, both general partners of Downtown, initially owned, controlled, and were general partners of Riverside. At or prior to the time that Burkhardt and Senturia solicited the consent of the limited partners, they allegedly told certain limited partners, including Allright, that an additional six million dollars would be invested in Riverside and that Riverside would borrow approximately eighteen million dollars (or roughly seventy-five percent of the construction cost) for the construction of the hotel on the property. The majority-in-interest of the limited partners approved the transaction, and the transfer of the interest in the property to Riverside was completed on or about March 30, 1984. A \$23,298,000 loan, secured by a mortgage on the property and by the personal guarantees of the four general partners of Riverside, was obtained from Savings Investment Service Corporation (SISCorp) for the construction of the hotel on the property. Apparently it was only after the transfer of the property to Riverside that the limited partners became aware of the fact that Burkhardt and Senturia never did seek the promised additional capitalization of Riverside and that instead of borrowing only seventy-five percent of the cost of the hotel, nearly one hundred percent of its cost had been borrowed from SISCorp. It is also alleged that only after the conveyance did the limited partners fully learn that Burkhardt and Senturia had paid the sum of \$981,000 out of the initial construction loan draw as a permanent loan commitment

fee for a permanent loan commitment that was nonexistent and that Burkhardt and Senturia had assessed Riverside several substantial fees payable to themselves or their affiliates, a significant portion of which was paid out of the initial construction loan draw.

After conveyance of the property, the general partners of Downtown, acting through Burkhardt and Senturia, solicited ratification of the conveyance by the limited partners but were unsuccessful. Between March 29, 1984, and July 5, 1984, Allright allegedly demanded that Downtown's general partners take whatever action necessary to recover the real property conveyed to Riverside or else to recover reasonable compensation from Burkhardt, Senturia, and/or Riverside. The general partners, though, apparently rejected Allright's demands for action.

On June 26, 1984, after construction on the hotel had already begun, Allright filed suit in federal district court, naming all the general partners and the other limited partners of Downtown as defendants. Allright later filed a First Amended Complaint on July 5, 1984, joining the mortgagee, SISCorp. Defendants subsequently moved to dismiss the complaint. Allright responded by filing a ninety-one page, sixteen count Second Amended Complaint. Count I alleged a violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961-1968 (1982), and sought treble damages against Burkhardt and Senturia; Counts II through VIII alleged a series of violations of federal securities laws and sought rescission of the transfer to Riverside; Counts IX through XI alleged violations of the Missouri securities laws and sought rescission of the conveyance to Riverside. The remaining counts were for breach of fiduciary duty, breach of the partnership agreement, dissolution and accounting, and removal of Senturia as a general

partner of Downtown. Afterwards, twelve of the twenty limited partners filed a cross-claim against the general partners, adopting Allright's claims and adding additional parties and claims.³ The district court granted defendants' motion to dismiss the federal and Missouri securities law claims on the ground that neither Allright nor the other limited partners had capacity to bring a derivative suit. The court also dismissed the other pending state law claims without prejudice. Upon defendants' subsequent motion, the district court entered an order dismissing the RICO claim—the only count remaining—finding that Allright had failed to allege sufficient acts for there to be a pattern of racketeering activity under the statute. These appeals followed.

I

Allright's major contention is that the district court erred in ruling that Allright and the other limited partners lacked the capacity to bring their federal and Missouri securities law claims derivatively. We agree.

The starting point for our analysis is Fed. R. Civ. P. 17(b), which states:

The capacity of an individual, other than one acting in a representative capacity, to sue or be sued shall be determined by the law of the individual's domicile. The capacity of a corporation to sue or be sued shall be determined by the law under which it was organized. In all other cases

³ Together with Allright, these limited partners constitute a majority of the limited partnership interests.

capacity to sue or be sued shall be determined by the law of the state in which the district court is held, except (1) that a partnership or other unincorporated association, which has no such capacity by the law of such state, may sue or be sued in its common name for the purpose of enforcing for or against it a substantive right existing under the Constitution or laws of the United States

Under the plain wording of the rule, we are required to apply state law (Missouri law in this instance) to determine whether the limited partners have the capacity to bring a derivative suit. *See Klebanow v. New York Produce Exch.*, 344 F. 2d 294, 296-97 (2d Cir. 1965); *Engl v. Berg*, 511 F. Supp. 1146, 1152-53 (E.D. Pa. 1981); *Smith v. Bader*, 458 F. Supp. 1184, 1136-87 (S.D.N.Y. 1978). While Missouri courts have not directly spoken on the question, several courts in other jurisdictions have recognized the right of a limited partner to bring a derivative suit. *See, e.g., Klebanow*, 344 F. 2d at 295-99, *Engl*, 511 F. Supp. at 1152-53; *McCully v. Radack*, 27 Md. App. 350, 340 A. 2d 374 (Md. Ct. Spec. App. 1975); *Jaffe v. Harris*, 109 Mich. App. 786, 312 N.W. 2d 381 (1981); *Riviera Congress Assocs. v. Yassky*, 18 N.Y. 2d 540, 223 N.E. 2d 876, 277 N.Y.S. 2d 386 (1966); *Strain v. Seven Hills Assocs.*, 75 A.D. 2d 360, 429 N.Y.S. 2d 424 (1980). These courts have tended to analogize the limited partner to those persons who traditionally have been allowed to institute legal action to protect their interests in property that is under the immediate and direct control of another person. A common analogy is to the corporate shareholder. As stated in *Klebanow*:

[I]n the main, a limited partner is more like a shareholder, often expecting a share of the profits, subordinated to general creditors,

having some control over direction of the enterprise by his veto on the admission of new partners, and able to examine books and "have on demand true and full information of all things affecting the partnership..." *See N.Y. Partnership Law §§98, 99, 112.* That the limited partner is immune to personal liability for partnership debts save for his original investment, is not thought to be an "owner" of partnership property, and does not manage the business may distinguish him from general partners but strengthens his resemblance to the stockholder; and even as to his preference in dissolution, he resembles the preferred stockholder.

344 F. 2d at 297. Another frequent analogy is to a beneficiary of a trust, who under generally recognized principles of law can bring an action on behalf of the trust when the trustee is the malfeasor or has wrongly refused to enforce a claim of the trust against an outsider. *See id.*, 344 F. 2d at 297-99; *Jaffe*, 312 N.W. 2d at 384; *Riviera*, 18 N.Y. 2d at 547-48, 223 N.E. 2d at 879-80, 277 N.Y. S. 2d at 392. A compelling argument is made in these cases that if a corporate shareholder and trust beneficiary can bring a suit on behalf of the corporation or trust when the directors or trustees fail to act or were themselves the wrongdoers, there is no good reason why a limited partner should not be able to bring a suit on behalf of the limited partnership under similar circumstances.

Besides being influenced by the jurisprudence in the related areas of corporations and trusts, the court in *Klebanow* also took note of the fact that a derivative suit provides a "speedier and more effective remedy" for injury to the partnership than the traditional relief

available to the limited partner of dissolution and winding up. 344 F.2d at 299. The ineffectiveness of the remedy of dissolution is illustrated by the fact that dissolution may force a limited partner to terminate a profitable investment because of the wrongdoing of a general partner; moreover, there may also be several potential tax consequences to a limited partner's taking this route, possibly making it on the whole more costly to dissolve the partnership than to tolerate the wrongdoing. See Note, Procedures and Remedies in Limited Partners' Suits for Breach of General Partners Fiduciary Duty, 90 Harv. L. Rev. 763, 765, 774-75 (1977). The other relief available to the limited partner, an action for an accounting of profits, can also be inadequate when there is ongoing malfeasance by management, *id.* at 765, or when the wrongdoing is by non-partners. See Hecker, Limited Partners' Derivative Suits Under the Revised Uniform Limited Partnership Act, 33 Vand. L. Rev. 343, 350 (1980). Given the fact that the remedies of dissolution and accounting are incapable of providing effective relief for many of the wrongs that can occur to the limited partners' interest, a more potent mechanism is needed. In our estimation, the derivative suit is such a device.

In arguing under Missouri law Allright and the other limited partners lack standing to bring a derivative suit, defendants refer us to a provision of Missouri's Uniform Limited Partnership Law, Mo. Ann. Stat. §359.260 (Vernon 1968) (repealed, effective January 1, 1989), which states that "[a] contributor, unless he is a general partner, is not a proper party to proceedings by or against a partnership, except where the object is to enforce a limited partner's right against or liability to the partnership." The language of this provision is taken from the Uniform Limited Partnership Act, promulgated in 1916 and adopted in all but one of the fifty states. See Hecker, *supra*, at 343, 351-53. Defendants argue that this language

indicates that Missouri did not recognize at the time this suit was filed the right of Allright or the other limited partners to bring a derivative suit. The court in *Klebanow* disarmed a similar attempt to use the same language in a New York statute to bar a derivative suit. 344 F. 2d at 298-99. It found that while this provision could be interpreted as completely prohibiting a derivative suit, it could just as well be construed as intended to eliminate the need to join limited partners in lawsuits where the partnership is involved, and to also provide that ordinarily—but not always—general partners are to control litigation matters. *Id.* at 298. The court found that because New York law was ambiguous on this point, and since a federal right was at stake in the case, it was entitled to decide the matter in a manner that would allow the federal claim to be asserted. *Id.* at 299. State courts have subsequently expanded *Klebanow* and applied it in instances where only state law claims are at issue; these courts have construed this provision, the interpretation of which was admittedly unsettled at the time of the *Klebanow* decision, as not barring limited partner derivative suits. *See, e.g., Jaffe*, 312 N.W. 2d at 383-85; *Riviera*, 18 N.Y. 2d at 547, 223 N.E. 2d at 879, 227 N.Y.S. 2d at 391; *Strain*, 429 N.Y.S. 2d at 427-28. We believe that Missouri courts will adopt the approach taken by these courts.

Defendants further point to the actions—and for that matter inaction—by the Missouri legislature in recent years as an indication that a derivative suit is barred here. Defendants find it significant that although the National Conference of Commissioners on Uniform State Laws incorporated in the Revised Uniform Partnership Act in 1976 a provision permitting limited partner derivative suits, the Missouri legislature did not add this provision when it amended its limited partnership act in 1983. It was not until 1985 that Missouri enacted legislation expressly allowing a limited partner to bring a derivative

suit.⁴ (Partnerships formed prior to January, 1987, such as Downtown, have until January 1, 1989, to elect to be governed by the revised act. Mo. Ann. Stat. §359.641 subd. 2 (Vernon Supp. 1987).) We do not find that the delay by the legislature in promulgating this provision can necessarily be construed to mean that Allright cannot bring a derivative suit at this time. A limited partner's right to bring a derivative suit had its origin at the common law, *see Klebanow*, 344 F. 2d at 295-99; we therefore need not find an express legislative grant of authority in order to be able to conclude that Allright can bring this suit. The fact that the Missouri legislature did not promulgate a provision in 1983 expressly allowing this type of suit to be maintained could be interpreted a number of ways. At best, it is unclear whether the legislature actually rejected a provision allowing limited partner derivative suits. Likewise, it is also ambiguous as to what the legislature intended when it eventually did enact such a provision but with language making the provision not immediately controlling on partnerships formed before January 1987. On the one hand, this provision could be interpreted to mean that the legislature intended to bar completely any derivative action by a limited partner in a partnership formed before January 1987, until such partnership elected to be governed by the revised act. On the other, it could just as well be construed to mean that with regard to partnerships formed prior to 1987, any right to bring a derivative suit before the partnership

⁴ Mo. Ann. Stat. §359.571 (Vernon Supp. 1987) states that "[a] limited partner may bring an action in the right of a limited partnership to recover a judgment in its favor if general partners with authority to do so have refused to bring the action or if an effort to cause those general partners to bring the action is not likely to succeed."

elected to be governed by its provisions would have to be derived from the common law, and not from any statutory grant. Because the intent of the Missouri legislature is ambiguous and based on the above-mentioned reasons for allowing a derivative suit—which we believe Missouri courts would find persuasive—we will resolve these ambiguities in favor of allowing a derivative suit to be brought in this instance.

Finally, we would be remiss if we failed to mention that a minority of courts have chosen not to follow the Klebanow line of cases, barring at least in some instances a limited partner from bringing a derivative suit. *See, e.g., Browning v. Maurice B. Levien & Co.*, 44 N.C. App. 701, 262 S.E. 2d 355 (N.C. Ct. App.), *appeal denied*, 300 N.C. 371, 267 S.E. 2d 673 (1980); *Fox v. Sackman*, 22 Wash. App. 707, 591 P. 2d 855 (Wash. Ct. App. 1979); *Amsler v. American Home Assurance Co.*, 348 So. 2d 68 (Fla. Dist. Ct. App. 1977), *cert. denied*, 358 So. 2d 128 (1978). Allright attempts to distinguish these cases on the basis that in each the limited partner was seeking to bring a derivative suit not against the general partners (what Allright terms an insider derivative suit), but against third parties (referred to by Allright as an outsider derivative suit). Characterizing its lawsuit as an insider derivative suit since it is principally directed against the general partners of Downtown, Allright argues that the cases denying the limited partner the right to bring suit are inapplicable.⁵ While these cases can perhaps be distinguished on factual grounds, we believe the better approach—and the approach the Missouri courts would follow—would be to allow the maintenance of a derivative suit without distinction as to

⁵ But note, however, that an outsider—the mortgagee—is a defendant in this case.

whether it is primarily directed against insiders or third parties. In the related areas of corporations and trusts, suits by shareholders or trust beneficiaries on behalf of the corporation or trust are not barred simply because the defendants in the suit are third parties. *See Restatement (Second) of Trusts* §282 (1959); Mo. Ann. Stat. §507.070 (Vernon 1952) and Mo. R. Civ. P. 52.09 (no special requirements when a shareholder derivative suit is brought against third parties). Also, logic and experience would dictate that a limited partner's investment in the partnership could be harmed just as greatly through the wrongful acts of third parties as it could through the actions of the general partners. As already discussed, other remedies available to the limited partners are often ineffective to remedy the harm caused to the limited partnership and the limited partner's interest therein. The adequacy of these remedies is often no better, and sometimes much worse, when outsiders are the ones guilty of the wrongdoing.

We hold that under Missouri common law Allright has the capacity to bring a limited partner derivative suit on its federal and Missouri securities law claims. We believe that Missouri courts will reject the approach taken by the minority of courts that have declined to allow limited partner derivative suits.⁶

⁶ Our conclusion forecloses the need to address Allright's argument that its federal and state securities law claims are not exclusively derivative.

Defendants next argue that even if a limited partner has standing to bring a derivative suit, Allright failed to comply with the requirements of Fed. R. Civ. P. 23.1 and accordingly should not be permitted to maintain this action.⁷ The district court did not rule on this contention, we may consider this argument, however, inasmuch as it would provide a basis to affirm the district court's

⁷ Fed. R. Civ. P. 23.1 states in pertinent part:

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which the plaintiff complains or that the plaintiff's share or membership thereafter devolved on the plaintiff by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for the plaintiff's failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association.

A partnership is an unincorporated association for purposes of Rule 23.1. *See Phillips v. Kula*, 200, 83 F.R.D. 533, 534 (D. Hawaii 1978).

decision. *See Reeder v. Kansas City Bd. of Police Comm'rs*, 733 F. 2d 543, 548 (8th Cir. 1984).

Defendants begin by asserting that Allright did not allege with particularity its efforts to obtain the desired action by the general partners of Downtown. We reject this contention. The demand required by Rule 23.1 serves the purpose of notifying management so that it can make the initial decision as to the type of action that should be taken, be it a lawsuit or some other form of corrective action, to resolve the problem at hand. *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 529-33 (1984); *Allison v. General Motors Corp.*, 604 F. Supp. 1106, 1117 (D. Del.), aff'd 782 F. 2d 1026 (3d Cir. 1985). At the very least, "a demand must identify the alleged wrongdoers, describe the factual basis of the wrongful acts and the harm caused to the (enterprise), and request remedial relief." *Allison*, 604 F. Supp. at 1117.

In paragraph 30 of its Second Amended Complaint, Allright pleaded the following facts:

- (1) Between March 29, 1984, and July 5, 1984, it demanded that the general partners of Downtown take whatever action was necessary to recover Downtown's property or to recover reasonable compensation therefor from defendants Burkhardt, Senturia and/or Riverside;
- (2) It reiterated its demands at a meeting for all the general partners and all of the limited partners on May 17, 1984;
- (3) No action was taken by the general partners of Downtown; and
- (4) Any further action would be futile since four of the six general partners of Downtown will always reject any

demand because they either personally benefitted or are related to general partners who have so benefitted.

Assuming, as we must, that the allegations in Allright's complaint are true, *see Flowers v. Continental Grain Co.*, 775 F. 2d 1051, 1052 n. 2 (8th Cir. 1985), we find that Allright's demand meets the requirement of Rule 23.1. The demand identified the alleged wrongdoers (i.e., Burkhardt and Senturia); described the wrongful act at issue (i.e., the conveyance to Riverside); implicitly denoted the harm caused to the partnership (i.e., implicit in the demand was the fact that there was an improper loss of a valuable partnership asset); and made a request for remedial relief (i.e., a return of the property, or in lieu thereof, reasonable compensation from Burkhardt, Senturia, and/or Riverside). In addition, defendants' position is further weakened by the fact Allright alleged in its complaint the futility of a demand due to the close proximity of the general partners to the alleged impropriety. If a demand would be futile, it need not be made. *See, e.g., Lewis v. Curtis*, 671 F. 2d 779, 784-87 (3d Cir.), cert. denied, 459 U.S. 880 (1982).

Defendants also assert that pursuant to Rule 23.1 Allright should have requested prior to filing this action or the Second Amended Complaint that the other limited partners, who by majority vote approved the conveyance, join in its efforts to rescind the sale. Rule 23.1 states that the plaintiff must "allege with particularity the efforts, if any, made by [him] to obtain the action [he] desires from the directors or comparable authority and, if necessary, from the shareholders or members ..." Courts have interpreted the "if necessary" requirement to mean that the necessity of making a demand on the shareholders or members should be governed by the applicable state law. *See Jacobs v. Adams*, 601 F. 2d 176, 179-80 (5th Cir. 1979); *Brody v. Chem. Bank*, 482 F. 2d 1111, 1114 (2d Cir.),

cert. denied, 414 U.S. 1104 (1973); GA Enters., Inc. v. Leisure Living Communities, Inc., 66 F.R.D. 123, 128 (D. Mass. 1974), aff'd., 517 F. 2d 24 (1st Cir. 1975). Although this approach may have merit when the underlying substantive claim is a state law claim, its persuasiveness is weakened when a federal claim is involved, especially when the policy underlying the federal right would be defeated by applying the state shareholder demand requirement. See 7C C. Wright, A. Miller & M. Kane, *Federal Practice and Procedure* §1832 at 122-23 (2d ed. 1986) (when a federal claim is at stake, the state shareholder demand rule should not be applied unless there is some "clear purpose" for doing so). It is clear that under Missouri law a demand must be made in the context of a shareholder derivative suit. See *Wolgin v. Simon*, 722 F. 2d 389, 392 (8th Cir. 1983). Nonetheless, we need not decide today whether Missouri's shareholder demand requirement applies so far as Allright's federal securities law claims are concerned, nor need we decide whether the Missouri shareholder demand requirement will be extended to limited partner derivative suits. Assuming for the sake of argument that the state shareholder demand requirement applies as a general rule to both federal and state claims brought derivatively by a limited partner in federal court, we find that a demand on the limited partners by Allright must be excused since it would be futile in this instance. Missouri courts have imposed this additional requirement to provide an opportunity for shareholder ratification of the allegedly improper act, thereby eliminating the necessity of a lawsuit. *Id.* Here, however, the limited partners have once before refused to ratify the transaction; and the pleadings reveal that a majority-in-interest of the limited partners have adopted Allright's position in this litigation, further evidencing the fact that ratification is a dead letter at this point.

We also reject defendants' assertion that Allright does

not fairly and adequately represent the interests of the limited partners for much the same reason. Defendants argue Allright has an interest adverse to the limited partners because Allright has an option to buy all of Downtown's real property if Allright is successful in frustrating the transfer to Riverside. Defendants once again ignore the fact that a majority-in-interest of the limited partners have openly supported Allright's position in this lawsuit, even to the extent of having Allright argue their position on appeal. At this point it would be disingenuous to say that Allright's position is contrary to that of the other limited partners.

We conclude that Allright has fulfilled the requirements of Rule 23.1 and thus has standing to present its federal and Missouri securities law claims.

III

In Counts II through XI (allegations that federal and state securities laws were violated), Count XIII (an allegation that Downtown's general partners breached the partnership agreement) of Allright's Second Amended Complaint, and in several counts of the cross-claims of the other limited partners of Downtown, Allright and the cross-claimants sought rescission of the conveyance to Riverside. Defendants assert as an alternative ground for upholding the dismissal of these counts that rescission is no longer an appropriate remedy because subsequent to the conveyance of the 1.5 million dollars worth of property to Riverside a twenty-four million dollar hotel was constructed on the land. This argument was the basis for Burkhardt's and Senturia's motion for summary judgment below. The district court did note rule on this motion because its other rulings eliminated the need to do so, but it did indicate that it would have granted the motion had it been necessary to address the issue.

We find that a dismissal of the claims on the basis of the inappropriateness of the requested relief would be premature at this point. First, material factual questions still exist. for example, defendants have argued that Allright should have voiced its discontent with the conveyance to Riverside at an earlier time—either during or prior to the hotel's construction. Allright, however, counters by asserting that no significant construction of the hotel had taken place at the time it first made its demand on the general partners to undo the conveyance and SISCorp. had disbursed only \$3,000,000 of the \$23,298,000 under the loan and deed of trust (half of which was immediately returned to it in the form of fees).

The ability to obtain restitution is generally dependent on the fact that the underlying circumstances have not materially changed. See Restatement of Restitution §142(1) (1937); *American Gen. Ins. Co. v. Equitable Gen. Corp.*, 493 F. Supp. 721, 756 (E. D. Va. 1980) (the premise of the remedy of rescission is "that the parties can be restored to the status quo ante"). The construction of the hotel on the property is clearly a change of circumstance. Nevertheless, a change of circumstances is not a defense to a claim for restitution if "the change occurred after the recipient had knowledge of the facts entitling the other to the restitution and had an opportunity to make restitution." See Restatement, *supra*, at §142(3); *American Gen.*, 493 F. Supp. at 757-58. A factual question thus exists whether or not defendants proceeded to construct the hotel in disregard of Allright's alleged protests. Furthermore, even if it is found that Allright cannot obtain rescission, it should be able to amend its complaint to request damages. See Fed. R. Civ. P. 15(a) (leave is to be freely given by the court when justice so requires so that a party may amend his pleadings). Any decision on the type of relief available is ordinarily made at the end of trial after all of the facts and circumstances have been

fully developed. *See Boggess v. Hogan*, 328 F. Supp. 1048, 1053-54 (N.D. Ill. 1971). Accordingly, summary judgment on the rescission claims would be inappropriate at this time.

IV

Allright contends that the district court erred in dismissing its RICO claim against Burkhardt and Senturia for failure to allege sufficient acts to establish a pattern of racketeering activity. To establish a claim under RICO there must be "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 (1985) (footnote omitted). We agree with the district court that a pattern of racketeering activity has not been adequately alleged here.

According to Allright, the following acts by Burkhardt and Senturia, if proven as having occurred in the manner that Allright has alleged, would constitute a pattern of racketeering activity under the Act: (1) acts of mail, wire, and securities fraud in connection with the sale of the limited partnership interests; (2) the wrongful sale of 1.3 acres of Downtown's property to Riverside in exchange for a twenty percent interest in Riverside and wrongful acts relating thereto; and (3) improper diversion of other assets to Burkhardt and Senturia and their affiliates.

We held in *Superior Oil v. Fulmer*, 785 F. 2d 252, 257 (8th Cir. 1986), that something more than a single scheme is required in order to establish a pattern of racketeering

activity.⁸ In *Superior Oil*, the defendants had engaged in several acts of fraud relating to the theft of liquid petroleum from Superior Oil's pipeline. *Id.* at 253-54. We found that such acts, amounting to what was deemed to be a single scheme to divert petroleum gas from the pipeline, failed to rise to the level of a pattern of racketeering activity. *Id.* at 257. In the present case, we agree with the district court that only a single scheme is present. Allright's allegations, if true, evince only a solitary scheme by Burkhardt and Senturia to wrongfully deprive the limited partners of their investment in the partnership. The fact that the alleged acts occurred over a number of years (from 1980 to 1984), *see, e.g., Ornест v. Delaware N. Cos.*, 818 F. 2d 651 (8th Cir. 1987); *Deviries v. Prudential-Bache Sec., Inc.*, 805 F. 2d 326, 329 (8th Cir. 1986), or were directed against several individuals and entities comprising the limited partnership interests, does not dissuade us from this conclusion. Accordingly, we hold that under the mandate of *Superior Oil* and its progeny there has not been a sufficient allegation of a RICO violation. Allright's RICO claim was thus properly dismissed.

⁸ While the decision in *Superior Oil* has not been without its critics, *see, e.g., United States v. Ianniello*, 808 F. 2d 184, 192 (2d Cir. 1986), *cert. denied*, 107 S. Ct. 3230 (1987); *Morgan v. Bank of Waukegan*, 804 F. 2d 970, 974-76 (7th Cir. 1986), it remains the law of this circuit. *See, e.g., Henning v. First City of Worthington*, No. 86-5320, slip op. at 5 n. 5 (8th Cir., July 7, 1987); *Madden v. Gluck*, 815 F. 2d 1163, 1164 (8th Cir. 1987) (per curiam), *petition for cert. filed*, 55 U.S.L.W. 3838 (U.S. June 16, 1987) (No. 86-1923). Though Allright does not say so in so many words, for all intents and purposes, it would have us to reverse this circuit's holding in *Superior Oil*. We of course are not at liberty to overrule the decision of a prior panel of this court. *See United States v. Lewellyn*, 723 F. 2d 615, 616 (8th Cir. 1983).

The district court held that after its dismissal of the federal and Missouri securities law claims, it was appropriate to dismiss the pendent state claims of Allright and the cross claimant limited partners. Dismissed were Allright's claims (which the other limited partners subsequently adopted) for recovery for breach of the partnership agreement, breach of fiduciary duty, and its claims for equitable relief in the form of dissolution and accounting, and removal of Senturia as a general partner of Downtown.⁹ Also dismissed were the other limited partners' claims for recovery from Downtown's general partners for misappropriation of partnership funds, fraud, fraudulent transfer of a portion of Downtown's property, and breach of contract, and their claim for recovery from SISCorp. for its alleged negligence in extending financing to Riverside for the construction of the hotel on the property.

The doctrine of pendent jurisdiction is one of discretion, not of right. *United Mine Workers v. Gibbs*, 383 U.S. 715, 726 (1966). Hence, even if state and federal claims "derive from a common nucleus of operative fact" and are such that a plaintiff "would ordinarily be expected to try them all in one judicial proceeding," a federal court need not in every case permit the state claims to be joined. *Id.*

⁹ Included in Allright's state law claims were its claims under the Missouri securities laws. The district court did not dismiss these counts for lack of pendent jurisdiction because by this time these claims had already been dismissed on the basis that the limited partners lacked the capacity to bring these claims derivatively. As a result of our determination that Allright and the cross-claimants have the capacity to bring these claims, the district court, on remand, must consider whether such claims should be joined under the doctrine of pendent jurisdiction.

at 725-26. Among the factors a court should consider are: the judicial efficiency of trying the claims together; the convenience and fairness to partners; the avoidance of needless questions of state law; the degree to which the state law claims predominate, if at all, over the federal claims; the nexus of the state claims to questions of federal policy; and the risk of jury confusion. *Id.* 726-27. At the time that the district court dismissed the pendent claims, all that remained was the RICO count. The pendent claims were dismissed on the basis that state law issues substantially predominated the case; that such issues were basically collateral to a determination of liability under RICO; and that the risk of jury confusion on the RICO counts would be heightened with the introduction of additional evidence not pertinent to the RICO claim. Having found that Allright has failed to allege sufficient acts to support its RICO claim but that it does have standing to bring its federal securities law claims, we vacate the district court's ruling dismissing the state claims and remand for a further determination regarding the propriety of allowing the state claims to be raised in this suit.

VI

Pursuant to Fed. R. Civ. P. 38(b), a party may request a jury trial as a matter of right "not later than 10 days after the service of the last pleading directed to such issue." Allright and the cross-claimants did not request a jury trial within this time period. Approximately six weeks prior to the date set for the nonjury trial, they did file a motion for a jury trial pursuant to Fed. R. Civ. P. 39(b), which provides that "notwithstanding the failure of a party to demand a jury trial in an action in which such a demand might have been made of right, the court in its discretion upon motion may order a trial by a jury of any or all issues." The motion for a jury trial was made when

only the RICO claim remained. The district court denied the motion, reasoning that: (1) the matters involved in the RICO count were too complex and were not "peculiarly suited to jury determination"; (2) the defendants would be prejudiced because they had prepared their case with a view toward a bench trial and a jury trial would undoubtedly mean additional preparation; and (3) the granting of a jury trial would necessitate the setting of a new trial date when the case had already been on a nonjury docket for over three months. Allright argues that the district court abused its discretion in denying the motion.

Since we find that there was no basis for a RICO claim in the facts alleged by Allright, we obviously need not reach the question of whether a jury trial should have been granted on this count. The circumstances have measurably changed since the time the motion for a jury trial was made. Whether the district court would grant a jury trial under these circumstances we cannot say. We vacate the order denying the motion for jury trial. Allright and the cross-claimants may on remand renew their request, making their argument in light of these changed circumstances. It will be within the sound discretion of the district court to grant or deny this motion.¹⁰

¹⁰

Allright also contends that the district court erred in denying several of its discovery requests. We find no abuse of discretion. *See Voegeli v. Lewis*, 568 F. 2d 89, 96 (8th Cir. 1977). Several of Allright's discovery requests called for information outside of the scope of the lawsuit or for information not discoverable under the federal rules absent a showing of compelling need. The other discovery requests were in the form of interrogatories. Although these requests were denied, the district court did permit Allright to depose other individuals who could supply the information Allright sought. Under the circumstances, this was reasonable.

Finally, although the district court did not address this point, Community Investment Services Corporation (Commnet), the transferee of the mortgagee SISCorp,¹¹ has argued that because Allright and the cross-claimants have failed to state a claim against it, it should be dismissed from the case. Commnet overlooks the fact, though, that pursuant to Fed. R. Civ. P. 19(a) it cannot be dismissed at this time because it is a necessary party. According to Rule 19(a):

A person who is subject to service of process and whose joinder will not deprive the court of jurisdiction over the subject matter of the action shall be joined as a party in the action if (1) in the person's absence complete relief cannot be accorded among those already parties, or (2) the person claims an interest relating to the subject of the action and is so situated that the disposition of the action in the person's absence may (i) as a practical matter impair or impede the person's ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk

¹¹ After SISCorp was dismissed from the case by the district court, but before the remaining RICO claim was ultimately dismissed against Burkhardt and Senturia, SISCorp transferred all of its right, title and interest in the mortgage and the debt which it secures to Commnet, a Florida Corporation. Since SISCorp claims no further interest in the note and deed of trust, Commnet has argued in its place in this appeal.

of incurring double, multiple, or otherwise inconsistent obligations by reason of the claimed interest, if the person has not been so joined, the court shall order that the person be made a party.

Allright and the cross-claimants requested rescission of the conveyance and cancellation of the deed of trust. Obviously, should the district court permit rescission, Commnet must be a party to the case so that complete relief can be granted and so that Commnet would have an opportunity to protect its interests. Moreover, even if other relief is awarded, such as traditional legal damages or rescissional damages, Commnet's interest may also be impaired.

VIII

In conclusion, we reverse the dismissal of the federal and Missouri securities law claims on the basis that Allright and the cross-claimants are entitled to bring a limited partner derivative suit under Missouri law. We affirm the dismissal of the RICO claims and the district court's rulings on Allright's discovery requests. We further hold that the requirements of Fed. R. Civ. P. 23.1 have been met; that dismissal on the ground that rescission is an improper remedy would be premature at this point; and that Commnet, as transferee of the mortgagee, should not be dismissed from the case at this time since it is a necessary party to this litigation. We vacate the dismissal of the state law claims and the district court's denial of Allright's motion for a jury trial and remand for further proceedings in accordance with our resolution of the issues.

This court's mandate shall issue forthwith.

APPENDIX K

OPINION OF THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT IN HMK CORPORATION V. WALSEY, NO. 86-3582, SLIP OP. (4TH CIR. SEPTEMBER 17, 1987)

UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

(Argued February 2, 1987 Decided September 17, 1987
Docket No. 86-3582

HMK CORPORATION, a Virginia
Corporation,

Plaintiff-Appellant,

-v.-

JOHN C. WALSEY; BARRY S. BLUMBERG;
SIGMA CJ ASSOCIATES, a Virginia limited
partnership; PETULA ASSOCIATES, LTD.,
an Iowa corporation; JOHN OR JANE DOE
ONE THROUGH TEN, persons unknown or
as yet unidentified who were employed by
or associated with or were predecessors or
successors in interest to John C. Walsey,
Barry S. Blumberg, Sigma CJ Associates and/
or Petula Associates, Ltd., or who were
person employed by, or associated with the
enterprises identified herein as The Boulders
and who were knowing and willing
participants, directly or indirectly, in the
conduct of such affair; RICHARD L.
HEDRICK; STANLEY R. BALDERSON, JR.;
JOHN OR JANE DOE ELEVEN THROUGH

TWENTY, persons unknown or as yet unidentified who were persons employed by, or associated with the enterprise identified herein as Chesterfield County Planning Department and who were knowing and willing participants, directly or indirectly, in the conduct of such enterprise's affairs; HAROLD C. KING; JACK S. HODGE; JOHN OR JANE DOE TWENTY-ONE THROUGH THIRTY persons unknown or as yet unidentified who were persons employed by, or associated with the enterprise identified herein as Virginia Department of Highways and Transportation and who were knowing and willing participants, directly or indirectly, in the conduct of such enterprise's affairs,

Defendants-Appellees.

Before:

HALL, PHILLIPS, and WILKINSON,
Circuit Judges.

GEORGE ROBERT BLAKEY (Notre Dame Law School; James G. Harrison; Lawrence D. Diehl; Ray P. Luphold, III; Marks, Stokes & Harrison, P.C. on brief), for appellant.

STEVEN L. MICAS, County Atty. (Jeffrey L. Mincks, Senior Asst. County Atty. on brief); Charles F. Witthoefft (Michael P. Falzone; Hirschler, Fleischler, Weinberg, Cox & Allen; Edward E. Willey, Jr.; Willey & Hall, P.C.; James T. Moore, Senior Asst. Atty. Gen.; John J. Beall, Jr., Senior Asst. Atty. Gen.; Caroline L. Lockerby, Asst. Atty. Gen., on brief), for appellees.

WILKINSON, Circuit Judge:

HMK Corporation, the plaintiff-appellant in this case, bought property on which it intended to build a large mixed use development. The Boulders Development, controlled by defendant-appellees John C. Walsey, et al., borders HMK's property. HMK alleges that the owners of the Boulders Development misled officials of Chesterfield County, Virginia, and the state Department of Highways and Transportation, thereby subverting the county's planning process. The result of this subversion, according to HMK, is that the defendant gained a windfall at HMK's expense. Based on these allegations, HMK sued the owners of Boulders under civil RICO, 18 U.S.C. §1964(c). The district court granted summary judgment to the defendants on several grounds. We do not resolve the problematic grounds addressed by the district court, however, because we hold that HMK has failed to allege a "pattern of racketeering activity" as required by the RICO statute.

I

The HMK property and the Boulders property are located in the "Jahnke-Chippenham Development Area" of Chesterfield County. This area is bounded on the east by Chippenham Parkway, on the north by the Southern railway, on the south by Midlothian Turnpike and the Beaufont Mall shopping center, and on the west by residences. Both developers proposed to develop their properties for a number of purposes, including office space, retail stores, apartments, and hotels. The County approved both the HMK and the Boulders development proposals with some modifications and conditions.

This is the eighth lawsuit in which HMK challenges the legality of decisions made by Chesterfield County affecting HMK's property and the adjacent Boulders property. In addition to six lawsuits in state court, HMK

has earlier sued in federal district court. *HMK Corp. v. County of Chesterfield*, 616 F. Supp. 667 (E.D. Va. 1985). In the present lawsuit, HMK alleges that the defendants and their co-conspirators defrauded the state and local government into granting the Boulders Development numerous benefits and saddling HMK with numerous burdens. These governmental decisions applied mainly to zoning and the related issues of condemnation and highway placement.

In their complaint and its appendices, appellants detail activities on the part of Boulders that allegedly constitute Boulders' scheme to defraud. Appellants contend that this fraudulent scheme consisted of several episodes of racketeering. These episodes span a period of four years. They include a series of misrepresentations, false statements, half-truths, and omissions to neighborhood residents, the county planning board, the Virginia Department of Highways and Transportation, and other state and local government officials. HMK alleges that through these fraudulent means Boulders sought to (1) secure enhanced zoning for the Boulders property, (2) keep the enhanced zoning while avoiding highway expenses by substituting access across HMK's land for the proposed "flyover" access to Chippenham Parkway, (3) obtain additional development capacity for the Boulders property, (4) obtain access across HMK's land by using threats of condemnation to extort a right-of-way from HMK, (5) delay the HMK development to shift the costs of constructing a highway extension to HMK, and (6) limit the zoning awarded to HMK, thereby placing HMK in an inferior position.

HMK argues that by supplying false or misleading information to the government and the public, Boulders committed multiple acts of mail fraud in violation of 18 U.S.C. §1341, wire fraud in violation of 18 U.S.C. §1343,

transportation fraud in violation of 18 U.S.C. §2314, and extortion in violation of 18 U.S.C. §1951. Because the RICO statute defines "racketeering activity" to include all these offenses, *see* 18 U.S.C. §1961(1), HMK argues that the actions of the defendants support numerous claims for treble damages under RICO.

Thus, HMK filed a second lawsuit in federal court. Specifically, HMK pled a violation of 18 U.S.C. §1962(c), which provides:

It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

HMK also pled a violation of §1962(d), which makes unlawful any conspiracy to violate RICO.

The district court granted the defendants' motion for summary judgment. *HMK Corp. v. Walsey*, 637 F. Supp. 710 (E.D. Va. 1986). The court ruled that most of the plaintiff's claims were barred for two reasons: first, they had been or could have been raised in the prior litigation, and second, they were time-barred by the state statute of limitations. The court also ruled that the claims that remained must be dismissed because they did not amount to a "pattern of racketeering activity." In reviewing HMK's appeal, we do not reach the issues of res

judicata or the statute of limitations.¹ We hold instead that HMK's allegations in their entirety do not amount to a pattern of racketeering activity, and hence that HMK has not adequately pled a RICO violation.

II

This circuit recently addressed the question of when a pattern of racketeering activity exists in a strictly commercial context. *International Data Bank v. Zepkin*, 812 F.2d 149 (4th Cir. 1987). That case drew upon the Supreme Court's discussion of the RICO pattern requirement in *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479 (1985). In the present case, we address the question of when a RICO pattern exists in a mixed commercial and political context.²

¹ A recent Supreme Court decision invalidates the district court's holding that HMK's action is time-barred by the Virginia statute of limitations. After the district court rendered its decision in this case, the Supreme Court heard argument on and decided the question of the appropriate statute of limitations to apply to RICO civil enforcement actions. In *Agency Holding Corp. v. Malley-Duff & Associates, Inc.*, 107 S. Ct. 2759 (1987), the Court held that the four year federal statute of limitations applicable to Clayton Act actions was the appropriate limitations period for civil RICO actions. *Id.* at 2767. The Supreme Court's decision renders invalid the district court's application of Virginia's one-year "catch-all" limitations period to civil RICO actions. HMK filed its complaint in this case on January 6, 1986. The activity and injuries alleged by HMK occurred within the previous four years. Therefore, HMK's action is not time-barred.

² As a preliminary matter, we note that HMK has identified the Chesterfield County Planning Department and the Virginia Department of Highways and Transportation as the enterprises some of the defendants are alleged to have been employed by or associated with. The word "enterprise" in §1962(c) has been broadly construed to encompass units of government as well as commercial entities. See *United States v. Long*, 651 F.2d 239, 240-41 (4th Cir. 1981)

In *Sedima*, the Court suggested that "[t]he 'extraordinary' uses to which civil RICO has been put" resulted partly from "the failure of Congress and the courts to develop a meaningful concept of 'pattern.'" 473 U.S. at 500. The Court also reviewed the legislative history of RICO in a footnote, intimating that RICO did not target the isolated offender and that the word "Pattern" in the statute means more than sporadic instances of criminal activity. *Id.* at 496 n. 14.

Lower courts responded to the Supreme Court's cue with differing interpretations of the pattern requirement. The Eighth Circuit held that several related instances of mail or wire fraud in pursuit of one continuing fraudulent scheme cannot amount to a pattern. *See Superior Oil v. Fulmer*, 785 F. 2d 252 (8th Cir. 1986). The Second and Eleventh Circuits have continued to emphasize the number of predicate offenses. *United States v. Ianniello*, 808 F. 2d 184 (2d Cir. 1986); *Bank of America v. Touche Ross & Co.*, 782 F. 2d 966 (11th Cir. 1986). The Seventh Circuit held that the existence of a pattern must be determined with regard to all the circumstances of a case, rather than an isolated factor or set of factors. *Morgan v. Bank of Waukegan*, 804 F. 2d 970 (7th Cir. 1986).

Our decision in *Zepkin* elaborated a case-by-case standard akin to that announced by the Seventh Circuit in *Morgan*. Under this standard, the court looks to the "criminal dimension and degree" of the alleged misconduct. *Zepkin*, 812 F. 2d at 155. The misconduct at issue in *Zepkin*, a securities fraud, was held to constitute "a single, limited scheme" and hence was not a pattern of racketeering activity. *Id.*

The existence of a pattern thus depends on context, particularly on the nature of the underlying offenses. Attention to the nature of the underlying offenses is

necessary because the heightened civil and criminal penalties of RICO are reserved for schemes whose scope and persistence set them above the routine. In *Zepkin* we examined the special characteristics of securities fraud in determining whether a pattern existed:

Without attempting an all-embracing definition of the pattern requirement, we believe that a single, limited fraudulent scheme, such as the misleading prospectus in this case, is not of itself sufficient to satisfy §1961(5). Nor do we find "a pattern" in the fact that one allegedly misleading prospectus reached the hands of ten investors. If the commission of two or more "acts" to perpetrate a single fraud were held to satisfy the RICO statute, then every fraud would constitute "a pattern of racketeering activity." It will be the unusual fraud that does not enlist the mails and wires in its service at least twice. Such an interpretation would thus eliminate the pattern requirement altogether.

812 F. 2d at 154-155.

This same focus on context is consistent with the approach taken by the Seventh Circuit in *Lipin Enterprises v. Lee*, 803 F. 2d 322 (7th Cir. 1986). The Seventh Circuit's later opinion in *Morgan* described how the analysis of the pattern requirement in *Lipin Enterprises* hinged on the characteristics of the dispute, which involved a stock acquisition, and how the pattern requirement could not be interpreted in a manner that would bring every controversy of a particular character within RICO's ambit:

In *Lipin*, the plaintiff alleged that the

defendants defrauded him as part of a single acquisition of over \$960,000 worth of stock. It is true that plaintiff was able to point to multiple predicate acts: a false statement made during negotiations for the sale, false financial statements, (and) a false opinion letter from the attorneys The existence of multiple predicate acts in *Lipin*, however, is only because the acquisition of stock in this context is a complicated transaction that requires many separate statements from a variety of persons: financial statements from the accountants, opinions from the lawyers, oral statements from the parties negotiating the sale, and so forth.

Morgan, 804 F. 2d at 976.

III

In the present case, we must look to the nature of the mixed commercial and political context of a development dispute. One characteristic of such disputes is that they typically require the involvement of many government decision makers at various stages of the approval process. It therefore cannot be sufficient just to point to multiple predicate acts in furtherance of a scheme to influence a development dispute; otherwise, every such dispute could lead to a cause of action under RICO.

Plaintiff HMK, like the plaintiff in *Lipin, supra*, has alleged many predicate acts of fraud. HMK's complaint is accompanied by a 129-page appendix that gives a detailed account of the defendants' alleged scheme to obtain favorable decisions from Chesterfield County in this development dispute. The presence of numerous

predicate acts, however, arises from the complexity of political processes in general, and from those that govern land development in particular.

Virginia law specifies the procedural requirements that must be satisfied in order to amend zoning regulations and classifications. Once a property owner petitions the local governing body or planning commission for a reclassification, the zoning statute provides that before the governing body adopts or approves the proposed amendment, it must be reviewed by the local planning commission. Both bodies must provide public notice and hold public hearings. Once action has been taken on the proposal, parties wishing to contest the decision may seek review in the state circuit court. Va. Code Ann. §§15.1-491, 15.1-493 (1950). *See Vinton v. Falcun Corp.*, 226 Va. 62, 65-66, 306 S.E. 2d 867, 869 (1983). Zoning decisions are complex and require consideration of numerous, important, and often competing, interests and concerns. Local planners and legislators must consider such diverse factors as congestion on public streets, adequacy of police and fire protection, adequacy of transportation, sewage facilities, and water, economic development and employment opportunities, and preservation of historic areas and agricultural and forest lands. *See* Va. Code Ann. §15.1-489 (1950). Such considerations necessarily require the participation of numerous agencies and organizations.

Nothing in HMK's allegations sets this development dispute above any other dogfight between developers. The district court placed this lawsuit, in its proper perspective:

"Although the parties have filed voluminous briefs and exhibits detailing the history of this case, the Court finds the case

extraordinarily simple. Two developers have crossed swords over a unified section of land so that advantages given one hamper the aspirations of the other."

HMK Corp., 637 F. Supp. at 711. The fact that a developer must seek multiple permits and approvals does not bring every such controversy within the ambit of RICO. Here the allegations pertain merely to the allocation of burdens and benefits in the development of two adjoining properties. HMK does not allege that the defendants have previously interfered in the county planning process before this development dispute began or that they have done so again in the period since.

In addition to the number of predicate acts, HMK also points to the span of time that the scheme covered—a span of more than four years. Yet the passage of time, like the complexity of the decisionmaking process, is more a reflection of the nature of zoning approvals rather than of the distinctively pervasive nature of the defendants' scheme. In a private, commercial context, the fact that a scheme spans many years might constitute powerful support for the finding of a pattern of racketeering activity. In a mixed commercial and political context such as this one, where interference in the political process is an important part of the alleged scheme, the passage of time may not have comparable significance.

Public bodies often proceed deliberately. The process of zoning approval often involves multiple hearings and opportunity for public comment. These hearings serve to inform public officials, provide a forum for public opinion, and permit landowners adversely affected by the proposed changes to voice their opposition. See 1 R. Anderson, *American Law of Zoning* 235-37 (3rd ed. 1986). This inevitably leads to a protraction of the

administrative process. But such delay is seen as a worthwhile price for the benefits of due process and accurate decisionmaking. An ordinary rezoning decision, not to mention decision involving the location of roadways, housing projects, shopping centers, or office complexes, always has the potential to generate intense public opposition, to implicate several levels of government, and to take time to resolve. We obviously do not intimate that a RICO pattern is impossible in such circumstances. The element of "continuity" necessary for a pattern of racketeering activity under RICO cannot, however, be viewed in a vacuum and apart from the inherent characteristics of the decisionmaking process.

Hence, neither the number of predicate acts nor the span of time elevates the alleged scheme in this case to a pattern of racketeering activity under RICO. The gravamen of HMK's complaint is that its opponents deceived various public bodies to obtain favorable land use decisions on the Jahnke-Chippenham tract. Although we hold that no pattern exists in the present case, we want to make clear that the pattern requirement certainly does not bar all RICO claims arising in the zoning context. Without attempting to rule on cases that are not before us, we note that a plaintiff who alleged pervasive involvement by a developer in the political process through widespread racketeering activity could indeed meet the pattern requirement. Allowing a RICO claim in more routine situations, where a loser in the political arena simply alleges misrepresentations made by the victor, "would undermine Congress's intent that RICO serve as a weapon against ongoing unlawful activities whose scope and persistence pose a special threat to the social well-being." *Zepkin*, 812 F. 2d at 155.

In enacting RICO, Congress did not intend to preempt and federalize the field of state business law. Since the federal cause of action does converge, however, with state actions that comprise predicate acts on which RICO is based, some overlap and displacement of state law is inevitable. To recognize a pattern of racketeering activity under these facts, however, would work a wholesale displacement of state authority that Congress never intended.

Congress provided strong measures to ensure compliance with RICO. In addition to the criminal penalties of imprisonment, fines, and forfeitures in §1963, Congress also provided strong incentives to civil enforcement. Section 1964(c) permits persons injured in their business or property by a RICO violation to recover treble damages and costs, including a reasonable attorney's fee. These strong incentives to civil enforcement carry with them the concomitant danger that traditional state causes of action aimed at rectifying individual instances of commercial misconduct will be relegated to a position of secondary importance. Such familiar state causes of action as common law misrepresentation and fraud, unfair trade practices, and wrongful franchise termination, not to mention the general run of commercial and contractual disputes, could be eclipsed or resolved primarily as pendent claims in federal court. To secure access to the federal courts and to recover treble damages and attorney's fees under RICO, litigants may attempt to recast such single, isolated schemes as a "pattern of racketeering activity." *See Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 504-05 (1984) (Marshall, J., dissenting). To permit plaintiffs injured in such schemes to bring their claims under RICO would consign state law to unprecedented federal oversight irrespective of the parties'

citizenship, and would deprive the states of jurisdiction over these local controversies in a way Congress never intended. Congress chose the "pattern requirement" of §1962(a) as the mechanism by which "ordinary claims of fraud best left to 'the state common law of fraud'" are distinguished from those activities of such a "criminal dimension and degree" as to warrant the extraordinary remedies of RICO. *Zepkin*, 812 F. 2d at 155.

In a mixed commercial-political controversy such as this one, vitiation of congressional intent would bring additional adverse consequences. Permitting litigants to sue under RICO after every loss in the legislative arena, based on allegedly fraudulent conduct by the victors, would impinge upon the separation of powers. Permitting a federal suit for fraud in every state of local political squabble would also impinge on the values of federalism to a far greater extent than the Supreme Court has previously allowed.

These values would be affected in important ways. First, such lawsuits would require federal courts to determine whether fraudulent activity was the cause of the local decision for which plaintiff seeks damages. Hence, courts would often have to discount the presumptively legitimate purpose of the decision of a local governing body and attempt to divine its "actual" purpose. Such inquiries into local land use decisions is, of course, required to determine whether stated purposes serve as pretexts for racially invidious intent, but the Supreme Court has noted that inquiries into legislative purpose are otherwise disfavored. *Arlington Heights v. Metropolitan Housing Corp.*, 429 U.S. 252, 265 (1977).

Second, such lawsuits would undermine the finality of legislative decisions. If the losers in every commercial dispute over zoning could routinely sue their opponents

in federal court for fraud, RICO would effect the wholesale transfer of that most basic of local controversies into a federal forum. That result would implicate many of the concerns expressed by this circuit in *Hutchinson v. Miller*, 797 F.2d 1279, 1285-87 (4th Cir. 1986). In that case, we held that the losing candidate in an election could not recover damages under civil RICO based on allegations of electoral misconduct. We expressed concern over "the continuing assaults on political legitimacy" posed by post-election damage suits brought in federal court by defeated candidates. *Id.* at 1286. Similarly, a RICO lawsuit to contest the methods by which the victors in a zoning fight secured a favorable legislative or administrative outcome would "impair the respect to which the enactments of those duly elected are entitled." *Id.*

V

The RICO statute is not, of course, the only statute or even the primary statute relating to the conduct of developers in land use disputes. State laws, including the laws of Virginia, provide extensive procedures under which developers can contest arbitrary zoning and condemnation decisions. Indeed, HMK vigorously pursued those remedies in its earlier state lawsuits. Federal and state criminal laws provide criminal penalties for fraud, bribery, extortion, and other such offenses. The enhanced civil and criminal remedies of RICO, however, are available only when the conduct at issue amounts to a pattern of racketeering activity.

Because the misconduct that HMK has alleged in this development dispute does not amount to a pattern of racketeering activity, the judgment of the district court is

AFFIRMED.

APPENDIX L

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT IN *H.J. INC.* *V. NORTHWESTERN BELL TELEPHONE CO., NO.* *87-5121, SLIP OP. (8TH CIR. SEPTEMBER 22, 1987)*

UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

(Submitted September 2, 1987,
Decided September 22, 1987)
Docket No. 87-5121

H.J. INC., a Minnesota corporation, KIRK DAHL, LARRY KRUGEN and MARY KRUGEN, individually and d/b/a Photo Images, SUSAN DAVIS, ROBERT NEAL, ISSAC H. WARD, RICHARD L. ANDERSON, THOMAS J. MOTT, and all others similarly situated,

Appellants,

-v.-

NORTHWESTERN BELL TELEPHONE COMPANY, A SUBSIDIARY OF U.S. WEST, A.B.C. individually and D.E.F. as corporations, and other unnamed coconspirators,

Appellees.

Before:

McMILLIAN, Circuit Judge, HENLEY, Senior Circuit Judge, and JOHN R. GIBSON, Circuit Judge.

HENLEY, Senior Circuit Judge:

Plaintiffs appeal from the district court's¹ order dismissing their complaint for failure to state a claim upon which relief could be granted. Fed. R. Civ. P. 12(b)(6); *H.J. Inc. v. Northwestern Bell Telephone Co.*, 648 F. Supp. 419, 430 (D. Minn. 1986). Appellants' complaint alleged, *inter alia*, violations of the Racketeer Influenced and Corrupt Organizations Act. 18 U.S.C. §§1961-68 (RICO). We affirm.

Because appellants' complaint was dismissed pursuant to Rule 12(b)(6), we view the facts alleged in their complaint in the light most favorable to them. *Bennett v. Berg*, 685 F. 2d 1053, 1057-58 (8th Cir. 1982), *cert. denied*, 464 U.S. 1008 (1983). The gravamen of appellants' complaint is that appellee Northwestern Bell Telephone Company undertook to illegally influence members of the Minnesota Public Utilities Commission (MPUC), the state regulatory body responsible for determining the rates which Northwestern Bell may charge. Appellants claim that Northwestern Bell sought to influence individual MPUC commissioners by various methods including cash gifts, employment offers, tickets to sporting and cultural events, airline tickets, meals and parties. Appellants allege a series of episodes beginning in 1980 and claim the practices continue through the present. The district court dismissed appellants' RICO claims for failure to allege a pattern of racketeering activity. *H.J. Inc.*, 648 F. Supp. at 423-26.

The core requirement for a RICO violation is a pattern of racketeering activity. 18 U.S.C. §1962. *See Sedima, S.P.R.L. v. Imrex Co.*, 105 S. Ct. 3275, 3287 (1985) At the

¹ The honorable Harry H. McLaughlin, United States District Judge, District of Minnesota.

minimum, at least two acts of racketeering activity² are required to establish a pattern. *Sedima*, 105 S. Ct. at 3285 n. 14. However, "while two acts are necessary, they may not be sufficient, indeed, in common parlance two of anything do not generally form a Pattern." *Id.* Prior to *Sedima* the pattern requirement could be met by simply pleading two acts of racketeering activity. See *Superior Oil Co. v. Fulmer*, 785 F. 2d 252, 255-56 (8th Cir. 1986). In *Sedima* the Supreme Court chastised Congress and the courts for failing to develop a workable definition of "pattern" which would limit the abuse of civil RICO. *Sedima*, 105 S. Ct. at 3287. Accordingly, this circuit has undertaken more meaningfully to construe the concept of "pattern."

We have followed the *Sedima* Court's intimations and have required the combination of continuity plus relationship to establish the necessary pattern. *Superior Oil*, 785 F. 2d at 257. See *Holmberg v. Marrisette*, 800 F. 2d 205, 209-10 (8th Cir. 1986), cert. denied, 107 S. Ct. 1953 (1987). "The term 'pattern' itself requires the showing of a relationship ... so, therefore, proof of two acts of racketeering activity, without more, does not establish a pattern" 116 Cong. Rec. 18940 (1970) (statement of Sen. McClellan), quoted in *Sedima*, 105 S. Ct. at 3285 n. 14. The relationship prong is met when two or more racketeering acts are shown to be in pursuit of the same overarching scheme. See *Holmberg*, 800 F. 2d at 210; *Superior Oil*, 785 F. 2d at 257. The district court found that appellants' complaint satisfied the relationship prong. *H.J. Inc.*, 648 F. Supp. at 425. We agree.

The burden of establishing the continuity prong has

²

"Racketeering activity" has been defined to include a broad range of criminal offenses. 18 U.S.C. §1961(1)

proven more onerous. "The target of (RICO) is ... not sporadic activity. The infiltration of legitimate business normally requires more than one 'racketeering activity' and the threat of continuing activity to be effective. It is this factor of continuity plus relationship which combines to produce a pattern." S. Rep. No. 91-617, p. 158 (1969), quoted in *Sedima*, 105 S. Ct. 3285 n. 14. In order to demonstrate the necessary continuity appellants must allege that Northwestern Bell "had engaged in similar endeavors in the past or that [it was] engaged in other criminal activities." *Deviries v. Prudential-Bache Securities, Inc.*, 805 F. 2d 326, 329 (8th Cir. 1986). A single fraudulent effort or scheme is insufficient. *Id.* See also *Ornest v. Delaware North Cos.*, 818 F. 2d 651, 652 (8th Cir. 1987) (single to defraud plaintiffs of sales scheme over eight years commissions); *Madden v. Gluck*, 815 F. 2d 1163, 1164 (8th Cir. 1987) (defendant engaged in a vast array of fraudulent activities in pursuit of a single goal to keep a company afloat in order to loot it). Appellants' complaint alleges no more than a series of fraudulent acts "committed in furtherance of a single scheme to influence MPUC commissioners . . ." *H.J. Inc.*, 648 F. Supp. at 425.

The district court did not err in finding that appellants' complaint failed to satisfy the continuity prong as articulated in this circuit.³ Therefore, because dismissal was appropriate under Rule 12(b)(6), we do not address .

³ We are aware that our continuity plus relationship approach to the pattern requirement is not without criticism. See *Sun Savings & Loan Association v. Dierdorff*, No. 86-5811, 56 U.S.L.W. 2110 (9th Cir. Aug. 7, 1987); *United States v. Ianniello*, 808 F. 2d 184, 192 (2d Cir. 1986).

the other issues raised in this appeal. The decision of the district court is affirmed.⁴

McMILLIAN, Circuit Judge, concurring:

I fully concur in the decision to affirm the district court's dismissal of the complaint for failure to satisfy the continuity prong of the pattern of racketeering test adopted by this circuit. I write separately only to state that I agree with Judge John R. Gibson that we should reconsider our pattern of racketeering test, in light of the contrary positions recently taken by several other circuits.

JOHN R. GIBSON, Circuit Judge, concurring:

I concur in the court's opinion because I am satisfied that this result is compelled by our earlier cases commencing with *Superior Oil Co. v. Fulmer*, 785 F. 2d 252 (8th Cir. 1986). In *Henning v. First Bank of Worthington*, No. 86-5320 (8th Cir. July 7, 1987), I concurred separately and expressed by view that the multiple scheme requirement that we have grafted onto the pattern element strays from the statutory language of RICO. The Second and Seventh Circuits, and now the Ninth Circuit, as well as numerous district courts and a respected scholar in this field, have

⁴ Appellants also allege in their complaint pendent state law claims which were dismissed by the district court when the basis for the pendent jurisdiction (the RICO claim) was dismissed. At oral argument the court was advised that state court proceedings had been or were to be initiated. We, of course, do not reach any such claims in this opinion.

criticized our position.¹

I believe, as stated in my separate concurrence in *Henning*, that when a proper case arises the multiple scheme requirement should be examined by the court en banc.

¹ See *Henning, supra*, footnote 5, and *Sun Savings & Loan Assn. v. Dierdorff*, No. 86-5811, 56 U.S.L.W. 2110 (9th Cir. Aug. 7, 1987)



No. 87-616

Supreme Court, U.S.

E I D E N

OCT 30 1987

JOSEPH F. SPANIOL, JR.

CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1987

HUBERT PARK BECK, DOROTHY FAHS BECK,
ROBERT J. BECK and OTTO WEINMANN,
Petitioners,

vs.

MANUFACTURERS HANOVER TRUST COMPANY;
MILBANK, TWEED, HADLEY & McCLOY;
KELLEY DRYE & WARREN; DONALD B. HERTERICH;
ISAAC SHAPIRO; and EDWARD ROBERTS, III,
Respondents.

SUPPLEMENTAL BRIEF TO
PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

STUART HECKER, ESQ.
Attorney for Petitioners
521 Fifth Avenue
New York, New York 10175
(212) 682-7070



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(Please note: The pagination of the Appendix continues
from that found in the Petition for Writ of Certiorari.)

FURTHER REASONS FOR ALLOWANCE OF THE WRIT

Petitioners respectfully submit this Supplemental Brief, pursuant to Rule 22.6 of this Court, to apprise the Court of two recent events relevant to its consideration of their petition for certiorari.

The Second Circuit's Reaffirmation of the *Beck* Rule

Subsequent to the service and filing of the petition for certiorari the Second Circuit decided *Albany Insurance Company v. Esses*, No. 86-7968 (2d Cir. October 15, 1987); the text of the opinion is reproduced as Appendix M.

In *Albany Insurance* the district court had dismissed a RICO complaint for failure to adequately plead a "pattern". On appeal the appellants contended that the "pattern" allegation met the Second Circuit's requirements as set forth in *United States v. Ianniello*, 808 F. 2d 184 (2d Cir. 1986), *cert. denied*, 107 S. Ct. 3229 & 3230 (1987).

Without expressly deciding the "pattern" question, the Second Circuit, citing the instant case, affirmed on the ground that the alleged "enterprise", which "had an 'obvious terminating goal or date'", was "not sufficiently 'continuing' to constitute a RICO 'enterprise' under 18 U.S.C. §§1961(4), 1962". Slip op. at 5718; Appendix M at 135A (citing *Beck*, 820 F. 2d at 51).

With the decisions in *Albany Insurance*; *Furman v. Cirrito*, No. 86-7283, slip op. (2d Cir. September 1, 1987) (to be reported at 828 F. 2d 898); and the instant case, "pattern" litigation in the Second Circuit has thus been thoroughly transmuted into "enterprise" litigation. And an "enterprise" under the rule of these cases, no matter how long in existence and irrespective of the number of

predicate acts it commits, cannot be a RICO enterprise under §1961(4) if it has a single goal or what the Court regards as a clear termination date.

As is set forth in the petition for certiorari, the application of "pattern" considerations to the concept of "enterprise" is violative of both §1961(4) and any conceivable reading of footnote 14 in this Court's opinion in *Sedima, S.P.R.L. v. Imrex Company, Inc.*, 473 U.S. 479, 105 S. Ct. 3275 (1985). Yet the approach of the Second Circuit finds its precise equivalent in that of the Fifth, *cf. Montesano v. Seafirst Corp.*, 818 F. 2d 423, 426-27 (5th Cir. 1987).

This Court's Denial of Certiorari In *Madden v. Gluck*

This Court recently denied certiorari in an Eighth Circuit case cited in the instant petition. *Madden v. Gluck*, 815 F. 2d 1163 (8th Cir.), *cert. denied*, 56 U.S.L.W. 3243 (U.S. October 6, 1987) (No. 86-1923). *Madden* is substantially different from the case at bar, however, involving only the question whether a single fraudulent scheme can constitute a RICO "pattern". The Eighth Circuit answered that question in the negative, and affirmed the District Court's dismissal of the complaint.

In this case the Second Circuit, reversing the District Court, held that a "pattern" had adequately been pled. It then went on, however, to read into the concept of "enterprise" this Court's statements regarding "pattern" in footnote 14 of *Sedima*, and held that the RICO "pattern" had not been committed by an "enterprise" within the meaning of §1961(4). The question on this application is whether that holding comports with the statutory definition of "enterprise" in §1961(4), and is within the ambit of footnote 14.

CONCLUSION

For the foregoing reasons, and those set forth in the petition for a writ of certiorari, it is respectfully submitted that this Court should grant the petition.

Respectfully submitted,

Stuart Hecker
Attorney for Petitioners
521 Fifth Avenue
New York, New York 10175
(212) 682-7070

APPENDIX M

DECISION OF THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT IN ALBANY INSURANCE COMPANY V. ESSES, NO. 86-7968, SLIP OP. (2D CIR. OCTOBER 15, 1987)

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 955—August Term, 1986

(Argued: March 27, 1987 Decided: October 15, 1987)
Docket No. 86-7968

ALBANY INSURANCE COMPANY,
Plaintiff-Appellant,

-against-

HARRY ESSES, SHOE TASTICS, INC., REPUBLIC NATIONAL BANK OF NEW YORK,
BUSH TERMINAL ASSOCIATES, HARRY B. HELMSLEY, LAWRENCE A. WIEN, IRVING SCHNEIDER, DR. WILLIAM SHERPICK,
INDUSTRY CITY ASSOCIATES, APPLEMAN OIL CORPORATION, LOIS ZENKER, ESTATE ASSOCIATES, JONE CONNER, PETER MALKIN, PHILLIS GELFMAN, Trustee for LISA GELFMAN, PHILLIS T. GELFMAN, Second Trustee for PETER T. GELFMAN,
HELMSLEY-SPEAR, INC., and A.P.A. WAREHOUSES, DIVISION OF SEA-JET TRUCKING & A.P.A. WAREHOUSES, INC.,

Defendants-Appellees.

Before:

TIMBERS, KEARSE, and PIERCE,
Circuit Judges.

Appeal from a judgment of the United States District Court for the Eastern District of New York (Bramwell, J.) dismissing appellant's civil action alleging violations of the Racketeer Influenced and Corrupt Organizations Act for failure to state a claim and appellant's pendent state law claims for lack of subject matter jurisdiction.

Affirmed.

NICHOLAS P. GIULIANO, Esq., New York, N.Y.
(Louis P. Sheinbaum, Stephen C. Kimmel,
Waesche, Shenbaum & O'Regan, New York, N.Y.,
of counsel), *for Plaintiff-Appellant.*

MARK D. LEBOW, Esq., New York, N.Y. (Wendy
L. Addiss, Coudert Brothers, New York, N.Y., of
counsel), *for Defendants-Appellees Harry Esses &
Shoe Tastics, Inc.*

JOHN HARTJE, Esq., New York, N.Y., (Ingrid R.
Sausjord, Kronish, Lieb, Weiner & Hellman, New
York, N.Y., of counsel), *for Defendant-Appellee Re-
public National Bank of New York.*

(Lewis I. Wolf, Smith, Mazure, Director & Wilkins,
New York, N.Y., of counsel), *for remaining Defen-
dants-Appellees.*

PIERCE, *Circuit Court Judge:*

This is an appeal from a judgment of the United States District Court for the Eastern District of New York, Henry Bramwell, Judge, dismissing the amended complaint of

appellant Albany Insurance Company ("Albany") pursuant to Rules 12(b)(6) and 12(b)(1) of the Federal Rules of Civil Procedure for failure to state a claim and for lack of subject matter jurisdiction. The district court dismissed appellant's civil claim which alleged that appellees Esses and Shoe Tastics, Inc., violated 18 U.S.C. §§1962(b), (c), and (d) (1982 & Supp. III 1985) of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §§1961-68. The amended complaint was dismissed for failure to adequately plead the "pattern" requirement of RICO, *id.* §§1961(5), 1962. The court therefore dismissed appellant's pendent state law claims for lack of jurisdiction. The district court also denied appellant's motion for leave to replead. We affirm.

BACKGROUND

Albany's civil RICO and pendent state law claims arise out of events that led to Esses's conviction on one count of mail fraud. According to Albany's amended complaint, Esses was president of Shoe Tastics, Inc. ("Shoe Tastics"), a New York corporation that imported and sold womens' shoes. In December, 1982, Shoe Tastics leased warehouse space located at Bush Terminal in Brooklyn, New York ("Shoe Tastics Warehouse"). The amended complaint alleges that, after leasing the warehouse space, Esses prepared bills of lading that falsely reported the transfer of shoes from another warehouse to the Shoe Tastics Warehouse in late February and early March 1983. It also alleges that Esses mailed monthly "Statements of Value" to the insurer of the shoes, Albany, that materially overstated the ~~value~~ of merchandise stored in the Shoe Tastics Warehouse. Albany had extended its marine cargo insurance policy with Shoe Tastics to cover the Shoe Tastics Warehouse goods after the original insurer of the goods, New England Reinsurance Company, cancelled its policy with Shoe Tastics in May

1983.

According to Albany's complaint, on or about November 8, 1983, Shoe Tastics allegedly filed a fraudulent insurance claim with Albany following a fire in the Shoe Tastics Warehouse on July 6, 1983. The claim allegedly included a sworn "Proof of Loss" statement, signed by Esses, claiming that \$1.4 million in inventory was lost. Albany paid \$1.4 million on the loss, based on the alleged fraudulent claim, to Shoe Tastics and to appellee Republic National Bank of New York (the "Bank"), which had a security interest in the goods.

In May 1985, Esses was indicted on one count of mail fraud and one count of arson arising from the fire and the insurance settlement. Following a jury trial before Judge Bramwell in the Eastern District of New York, Esses was convicted on October 29, 1985, of one count of mail fraud based on charges that, as part of a scheme to defraud Albany, he submitted false valuation statements and a false insurance claim to Albany via the mails. The charge of arson against Esses was dismissed for insufficient evidence. Albany commenced this civil action on May 19, 1986. Albany sought a recovery in the amount of \$1.4 million, trebled pursuant to 18 U.S.C. §1964(c), alleging that Esses and Shoe Tastics had engaged in a "pattern of racketeering activity" in violation of the RICO statute, 18 U.S.C. §§1962(b), (c) & (d). Invoking both federal question and admiralty jurisdiction, Albany also alleged several pendent state law claims of fraud, misrepresentation, and nondisclosure and concealment against Esses and Shoe Tastics, and claims of unjust enrichment, breach of contract, fraud, and negligence against the remaining defendants.

The district court concluded that: 1) Albany had failed to plead adequately a "pattern of racketeering activity;"

2) admiralty jurisdiction was absent; and 3) the court consequently had no jurisdiction over the remaining state law claims. Judge Bramwell stated that the "continuity plus" language of *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 n. 14 (1985), required more than the "merely multiple predicate acts committed in furtherance of a single isolated scheme" alleged by Albany in order to establish a racketeering pattern. After hearing reargument, the district court held that a change in its original ruling was not required by our then recently reported opinion in *United States v. Teitler*, 802 F. 2d 606 (2d Cir. 1986). The court also denied without opinion appellant's motion for leave to replead.

On appeal, Albany contends that its amended complaint alleges a "pattern of racketeering activity" which meets the requirements of this Court as set forth in *United States v. Ianniello*, 808 F. 2d 184 (2d Cir. 1986), *cert. denied*, 107 S. Ct. 3229 & 3230 (1987). Appellant also argues that the district court abused its discretion in denying its request for leave to replead. Albany does not appeal the district court's decision regarding the absence of admiralty jurisdiction.

DISCUSSION

The primary issue in this appeal is whether Esses's and Shoe Tastics's alleged fraudulent acts, as set forth in Albany's amended complaint, constitute a "pattern of racketeering activity" as required by RICO. *See 18 U.S.C. §§1961(5), 1962.* By definition, a "'pattern of racketeering activity' requires at least two acts of racketeering activity." *Id. §1961(5).* Each mailing alleged as part of the fraudulent scheme could constitute a violation of the federal mail fraud statute. *See United States v. Weatherspoon*, 581 F. 2d 595, 601-02 (7th Cir. 1978); *United States v. Eskow*, 422 F. 2d 1060, 1064 (2d Cir.), *cert. denied*, 398 U.S.

959 (1970). The RICO "predicate act" required is thereby met. See *Weatherspoon*, 581 F. 2d at 602; 18 U.S.C. §1961(1)(B), (5).

In *Sedima*, however, the Supreme Court indicated that "'proof of two acts of racketeering activity, without more, does not establish a pattern.'" 473 U.S. at 496 n. 14 (quoting 116 Cong. Rec. 18940 (1970) (statement of Sen. McClellan)). To establish "'more,'" there must be a "'threat of continuing activity.'" *Id.* (quoting S. Rep. No. 617, 91st Cong., 1st Sess. 158 (1969)). The Court emphasized that "[i]t is this factor of *continuity plus relationship* which combines to produce a pattern." *Id.* (quoting S. Rep. No. 617, 91st Cong., 1st Sess. 158 (1969)) (emphasis in original). "Continuity plus" was required because RICO was not aimed at sporadic criminal activity or at the isolated offender. *Id.*

In *Ianniello*, this Court indicated that it is primarily the RICO "enterprise," 18 U.S.C. §1961(4), that supplies the "continuity and relationship" among the predicate acts that is necessary to establish a RICO violation. 808 F. 2d at 190, 191. In this Circuit, a RICO "enterprise" must be a continuing operation and the predicate acts must be related to the common purpose of the enterprise. *Id.* The continuity and relationship of the predicate acts in question in *Ianniello* were supplied by a "continuing criminal enterprise" whose single scheme and common purpose of skimming profits "continu[ed] indefinitely" and "had no obvious terminating goal or date." *Id.* at 191-92.

Recently, this Court upheld a district court's dismissal of a RICO complaint for failure to adequately plead the RICO "enterprise" requirement. See *Beck v. Manufacturers Hanover Trust Co.*, 820 F. 2d 46, 51-52 (2d Cir. 1987). In *Beck*, the appellant's amended complaint had alleged multiple related predicate acts committed by the alleged enter-

prise as part of a scheme to defraud bondholders. *Id.* at 49. Noting that *Ianniello* emphasized the necessity of a "continuing" enterprise under RICO, *id.* at 51, the Court concluded that

the enterprise alleged by plaintiffs had but one straightforward, short-lived goal—the sale of the U.S. collateral at a reduced price. At the conclusion of the sale, the alleged enterprise ceased functioning. Cf. *United States v. Ianniello, supra*, 808 F. 2d at 191-92 (noting that "[t]he common purpose in this case was to skim profits and had *no obvious terminating goal or date*" (emphasis added)). Such an association is not sufficiently continuing to constitute an "enterprise" under 18 U.S.C. §§1961(4), 1962(c).

Id.

Albany contends that Esses and Shoe Tastics, as alleged in the amended complaint, constitute a "continuing" enterprise meeting *Ianniello's* requirements. We disagree. Whereas the purpose of the enterprise alleged in *Ianniello*—skimming profits—had "no obvious terminating goal or date," *id.* at 192, the purpose of the enterprise alleged in Albany's amended complaint had an "obvious terminating goal or date"—inducing the insurer of its goods to pay a false insurance claim. There is nothing in Albany's amended complaint that indicates a threat of continuing criminal activity beyond this terminating goal. With its "straightforward and short-lived goal," the enterprise alleged by Albany is not sufficiently "continuing" to constitute a RICO "enterprise" under 18 U.S.C. §§1961(4), 1962. *Beck*, 820 F. 2d at 51. We therefore affirm the dismissal of the RICO claim.

Appellant also argues that the district court erred in denying its request for leave to replead. Rule 15(a) of the Federal Rules of Civil Procedure provides that permission to amend a pleading "shall be freely given when justice so requires." However, the district court may deny leave to replead if the proposed amendments would be futile. *See, e.g., Foman v. Davis*, 371 U.S. 178, 182 (1962); *Niagara Paper Corp. v. Paper Ind. Union-Management Pension Fund*, 800 F. 2d 742, 749 (8th Cir. 1986); *Marcraft Recreation Corp. v. Frances Devlin Co.*, 506 F. Supp. 1081, 1087 (S.D.N.Y. 1981).

In our opinion, Albany's proposed amendments would serve no useful purpose. Albany claims that had its request for leave to replead been granted, it would have alleged two additional "schemes" that would have satisfied the "pattern" requirement. The first was Esses's and Shoe Tastics's alleged scheme to swindle the New England Reinsurance Company, the original owner of its warehouse goods. The second was an alleged act of arson by Esses and Shoe Tastics. Both allegations would do nothing to establish the "continuity plus" that *Ianniello* requires to establish a "pattern". Even if New England had been the initial target of the fraud, Esses's and Shoe Tastics's alleged enterprise still had only one target—the insurer of its shoes—and one finite goal—inducing the insurer to pay a fraudulent insurance claim. Arson, even if proven, would merely have supplied evidence of an additional predicate act, not evidence of a threat of continuing criminal activity. Accordingly, the district court did not abuse its discretion in denying leave to replead.

Appellant's remaining claims sound in state law. Jurisdiction over those claims was premised on the doctrine of pendent jurisdiction. *See generally* 13B C. Wright, A. Miller & E. Cooper, *Federal Practice and Procedure* §3567.2 (2d ed. 1984). Since the only subject matter

jurisdictional basis for this lawsuit, the RICO claim, was properly dismissed, it was well within the discretion of the district court to dismiss the pendent state law claims. *See United Mine Workers v. Gibbs*, 383 U.S. 715, 726 (1966); *Uniformed Firefighters Ass'n v. City of New York*, 676 F.2d 20, 23 (2d Cir.), cert. denied, 459 U.S. 838 (1982).

For the foregoing reasons, we affirm the judgment of the district court.



DEC 14 1987

RONALD F. SPANIOL, JR.
CLERK

In the
Supreme Court of the United States
OCTOBER TERM, 1987

HUBERT PARK BECK, DOROTHY FAHS BECK,
ROBERT J. BECK and OTTO WEINMANN,

Petitioners,

vs.

MANUFACTURERS HANOVER TRUST COMPANY;
MILBANK, TWEED, HADLEY & McCLOY;
KELLEY DRYE & WARREN; DONALD B. HERTERICH;
ISAAC SHAPIRO; and EDWARD ROBERTS, III,

Respondents.

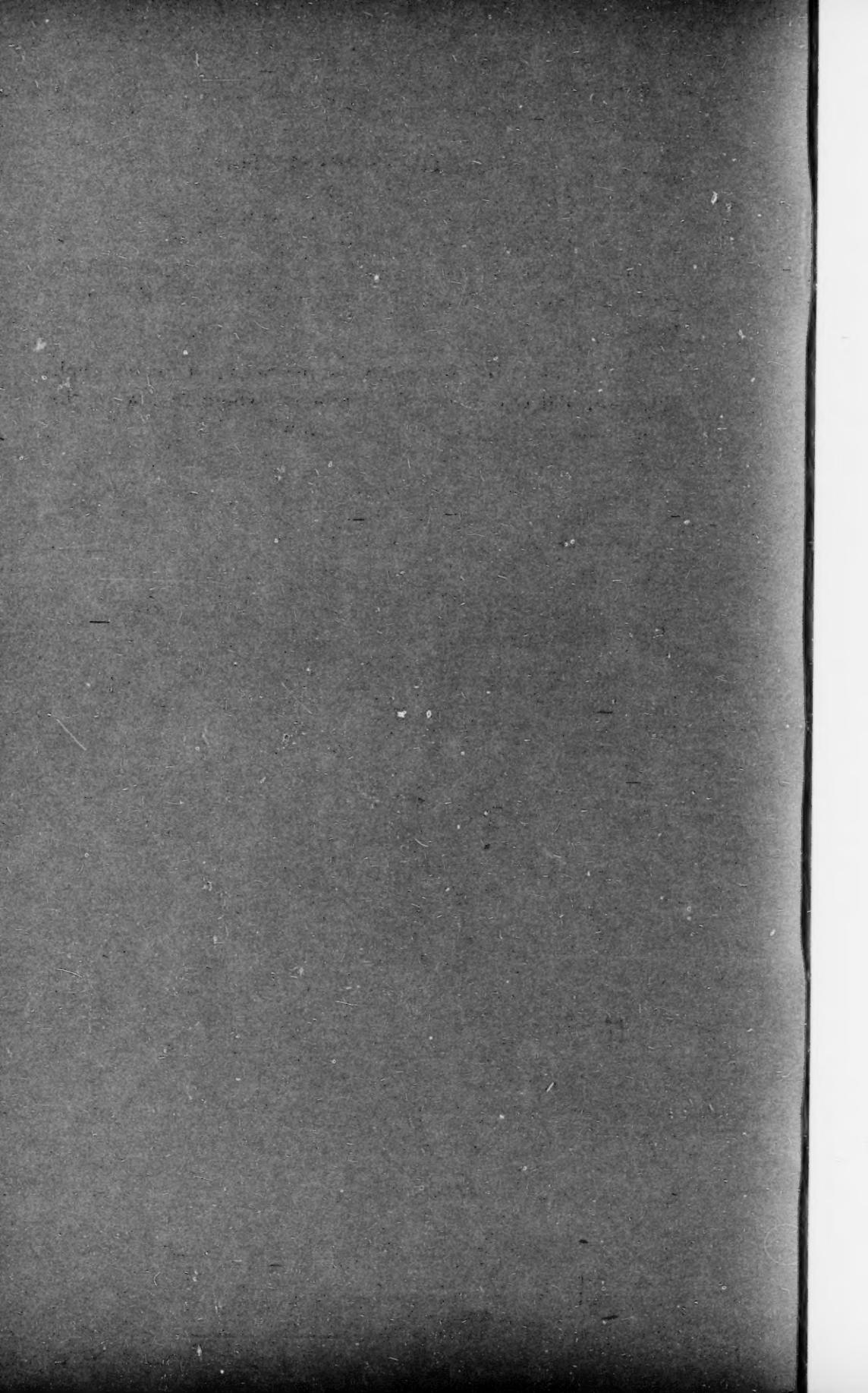
**OPPOSITION TO PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT**

ADLAI S. HARDIN, JR.
1 Chase Manhattan Plaza
New York, NY 10005
(212) 530-5000
Attorney for Respondents

Of Counsel:

ANDREW CITRON
JOANN CRISPI

MILBANK, TWEED, HADLEY & McCLOY
1 Chase Manhattan Plaza
New York, NY 10005
(212) 530-5000



QUESTIONS PRESENTED

- (1) Should this Court review the Second Circuit's unexceptional application of *United States v. Turkette* in concluding that an alleged association with one straightforward, short-lived goal lacks sufficient continuity to be a RICO enterprise?
- (2) Should this Court review the Second Circuit's application of RICO's pattern requirement, where review of this issue could not change the result below?

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STATEMENT OF THE CASE

This action under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §§ 1961-1968 (1984), is petitioners' third lawsuit alleging substantially the same factual claims. The first two were brought in the New York state court under the caption *Beck, et al. v. Manufacturers Hanover Trust Company*, Nos. 12896/83 and 15145/85 (Sup. Ct. N.Y. Co.) and are still pending. The facts, set forth in the District and Circuit Court opinions (1A and 27A),¹ may be summarized.

Petitioners held \$1,500 and \$150,500 principal amount of two series of bonds issued in 1902 by a Utah corporation which operated railway properties primarily located in Mexico. In 1908 the assets and liabilities of the Utah corporation were taken over by Ferrocarriles Nacionales de Mexico, which operated Mexico's railroads. Both bond issues have been in default since 1914. Over the years the Government of Mexico acquired approximately 96% of both bond issues, leaving less than 5% of the bonds (referred to as "non-assenting" bonds) in the hands of members of the public such as the petitioners.

Respondent Manufacturers Hanover Trust Company ("Manufacturers") is the successor trustee for both bond issues. As trustee Manufacturers held certain railway properties and related assets located in the United States and therefore not subject to the 1908 takeover by Ferrocarriles. This property, referred to as the "U.S. collateral", generated a small amount of income which was paid out to holders of the bonds in a series of distributions between 1942 and December 1981, seven of which were made after petitioners acquired their bonds.

The bond indentures permitted holders of 75% or more of the bonds to direct the trustee to liquidate the collateral. In accordance with this provision and the instruction of the Mexican Government, Manufacturers sold the U.S. collateral in a public auction in December 1982 pursuant to a widely published notice which stated that the minimum price that

¹ References are to the Appendices to the Petition and Petitioners' Supplemental and Second Supplemental Briefs.

would be accepted at the auction was \$31 million. The indentures also provided that the purchase price at such a sale could be paid by tendering a proportionate face amount of the bonds. The Mexican Government assigned the approximately 96% of the bonds which it owned to a company called Mexrail, Inc., and that corporation, being the only bidder, purchased the U.S. collateral for the upset price of \$31 million and paid the purchase price by tendering the bonds assigned by the Mexican Government and cash proportionate to the approximately 4% of "non-assenting" bonds. The cash was then distributed by Manufacturers to the non-assenting bondholders, including petitioners.

In the state court actions petitioners assert two basic claims. First, with respect to the seven distributions of income prior to the public auction, petitioners contend that Manufacturers was wrong in treating the Government of Mexico as a holder of the bonds which it held; they argue that the bonds acquired by Mexico should have been treated as redeemed and cancelled, and that 100% of the amounts distributed should have been paid to the holders of the approximately 4% of non-assenting bonds. Second, with respect to the public auction of the U.S. collateral in 1982, petitioners claim (i) that the U.S. collateral was worth far more than \$31 million and should have been sold at a higher price, and (ii) that 100% of the proceeds of the sale should have been distributed in cash to the holders of the approximately 4% of the non-assenting bonds.

None of the claims in the state court actions is based on fraud. Petitioners allege breach of fiduciary duty and negligence, and there is no allegation of any sort of fraud or deception.

Factually, the RICO claims in this action are virtually identical to the state court claims. The state court claim with respect to the seven interim distributions is alleged in this action as "Phase I"; the state claims with respect to the sale of the U.S. collateral are realleged here as "Phase II". Aside from a welter of technical RICO allegations, the only substantive difference is that in the federal complaint petitioners have changed their tort

theory from breach of fiduciary duty to fraud by repeatedly using the words "fraudulent" or "fraudulently", but without alleging a single fact demonstrating that Manufacturers committed any misrepresentation, false or misleading statement, material omission or other deceptive act evidencing fraud.

— The only other substantive difference between the state and federal complaints is the addition of a "Phase III", which alleges that the Government and people of Mexico were somehow defrauded with respect to the public auction. Petitioners do not represent or act as ombudsmen for the Mexican Government or people. They have no standing to maintain the Phase III claim and the federal courts have no jurisdiction to entertain it.

REASONS FOR DENYING THE WRIT

I. This case is inappropriate for Supreme Court review because it does not involve any clearly definable criminal conduct.

Before turning to the alleged conflicts between the circuits, it should be observed that this action presents an unlikely vehicle for this Court to clarify the statutory terms "pattern of racketeering activity" and "enterprise", because the amended complaint does not allege any racketeering activity. There is no clearly identifiable allegation of any predicate act constituting criminal conduct by any of the defendants. This is evident from the treatment of the fraud question by the District and Circuit Courts.

The District Court dismissed petitioners' fraud claims as to all three phases for failure to comply with Fed. R. Civ. P. 9(b) (13A), in that petitioners —

have not stated facts that support their claim that defendants' acts, in essence alleged breaches of fiduciary duty, were done with the requisite scienter The facts alleged point to a breach of fiduciary duty rather than fraud. (15A)

The Second Circuit agreed with the District Court's dismissal of Phase I for failure to plead scienter (34A), but held as to Phases II and III, that "plaintiffs have adequately pled scienter" having alleged "two sets of unusual circumstances surrounding the sale of the U.S. collateral that give rise to a strong inference of scienter" (34A). But the alleged presence of these two "sets of unusual circumstances" hardly provides a paradigm case of fraud for review.

As stated repeatedly by this Court and in the legislative history, RICO is a criminal statute designed to strike at the economic roots of organized crime. Essential to any criminal or civil charge based on RICO is an allegation that the defendants engaged in two or more predicate acts of "racketeering activity" as defined in section 1961(1). The alleged "racketeering activity" here is mail and wire fraud. But neither of the lower courts was able to identify any comprehensible factual allegation of fraud in the amended complaint, because petitioners' claims, in reality, are based on breach of fiduciary duty.

If the evolving interpretations of "pattern" and "enterprise" merit reexamination at this time, this case is not an appropriate vehicle for such a review because it does not involve any discernible criminal conduct. The precedential value of a decision analysing "pattern of racketeering activity" must be clouded, at best, in a case where no one can define what the "racketeering activity" is. If the concepts of "pattern" and "enterprise" are to be reevaluated in light of the decisions subsequent to *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479 (1985), it is respectfully submitted that such analysis should proceed in the context of clearly articulated allegations of racketeering activity, rather than in a factual context involving the administration of a trust where no criminal conduct is readily apparent.

II. The alleged conflict among the circuits on "pattern" does not merit review at this time, or in this case.

Petitioners' claims of conflict among the circuits and portents of chaos respecting the "pattern" requirement are

highly exaggerated. The circuit courts are in agreement on the "relatedness and continuity" test for pattern discussed by this Court in footnote 14 of *Sedima*. Moreover, in determining whether a pattern exists the courts all apply the same set of factors mentioned in *Sedima* — the number of participants, the number of victims, methods of commission, purposes of the conduct, extent of the results and injuries and the inter-relationship between the predicate acts.²

Petitioners suggest two areas of divergence. The first is whether a RICO pattern requires more than one scheme. The circuits, with the exception of the Eighth Circuit, uniformly hold that it does not.³ The Eighth Circuit alone requires that the predicate acts be committed in the course of multiple schemes in order for a pattern of racketeering activity to be alleged. However, in the most recent Eighth Circuit decision, *H.J. Inc. v. Northwestern Bell Telephone Co.*, 829 F.2d 648 (8th Cir. 1987) (reproduced at 123A), two judges indicated that the "multiple schemes" rule should be reexamined by that Court *en banc*, stating:

The Second and Seventh Circuits, and now the Ninth Circuit, as well as numerous district courts and a respected scholar in this field, have criticized our position.

² Insofar as the Second Circuit takes a more liberal view of pattern, of course, petitioners have been the beneficiary of that view below.

³ See *Roeder v. Alpha Industries, Inc.*, 814 F.2d 22, 31 (1st Cir. 1987); *United States v. Ianniello*, 808 F.2d 184, 192 (2d Cir. 1986); *Barticheck v. Fidelity Union Bank/First National*, 832 F.2d 36 (3d Cir. 1987); *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149, 155 (4th Cir. 1987); *R.A.G.S. Couture, Inc. v. Hyatt*, 774 F.2d 1350 (5th Cir. 1985); *Morgan v. Bank of Waukegan*, 804 F.2d 970, 975 (7th Cir. 1986); *Sun Savings & Loan Association v. Dierdorff*, 825 F.2d 187, 193 (9th Cir. 1987); *Torwest DBC, Inc. v. Dick*, 810 F.2d 925, 929 (10th Cir. 1987) (declining to formulate a bright-line test, but not ruling out that a single scheme may constitute a pattern); accord, *Condict v. Condict*, 815 F.2d 579, 584-85 (10th Cir. 1987); *Bank of America v. Touche Ross & Co.*, 782 F.2d 966, 971 (11th Cir. 1986).

I believe, as stated in my separate concurrence in *Henning*, that when a proper case arises the multiple scheme requirement should be examined by the court en banc (127A-128A).

Thus, it appears that the circuits are moving towards uniformity -- on their own, and intervention by this Court at this time is unnecessary and premature.

Petitioners also argue that "whether a single-purpose scheme must be open-ended to constitute a 'pattern' has recently been considered by the Third, Fourth and Tenth Circuits, with totally irreconcilable results" (Second Supp. Brief 4). But the three circuit court decisions cited by petitioners (reproduced at 138A, 144A and 154A) provide no evidence of a real conflict even on this issue. The Third Circuit in *Barticheck v. Fidelity Union Bank/First National State*, 832 F.2d 36 (3d Cir. 1987), expressly rejected "the view that racketeering acts committed pursuant to a single scheme can constitute a RICO pattern only if the scheme is potentially ongoing or open-ended" (162A). No conflicting statement of law appears in either the Fourth or Tenth Circuit opinions cited by petitioners. Both Circuits have stated that they have not formulated a hard and fast test for determining a RICO pattern (141A, 151A) and have only stated that "discreet" or "limited" schemes do not constitute a "pattern". This is entirely harmonious with the Third Circuit's approach, which focuses on the "extent" of the racketeering activity and likewise eschews a general formulation in favor of an inquiry into continuity and relationship based on the facts of each case (162A).

In short, the law on the "pattern" requirement is evolving as the circuit courts seek to apply the precepts articulated in *Sedima* footnote 14 to the facts of particular cases. Analysis of the decisions reveals that apparent differences often are more a

matter of nomenclature than substance,⁴ and to the extent that there is a real dichotomy reflected in the Eighth Circuit's multiple schemes rule, at least two judges on that court are prepared to reconsider the issue *en banc* in an appropriate case. Certiorari has been denied in the past to permit "further study" in the lower courts. *McCray v. New York*, 461 U.S. 961, 963 (1983).

Certiorari is also inappropriate in a case, such as this, where resolution of a conflict between the circuits could not change the result reached below. *See Sommerville v. United States*, 376 U.S. 909 (1964). Petitioners prevailed below on the pattern requirement, and they do not stand to gain anything by further review of that issue. In short, petitioners have no standing to complain about a conflict in the circuits on the issue of pattern, because they were not harmed by that conflict below.

If this Court viewed the Eighth Circuit's "multiple schemes" rule as meriting review at this time, surely the Court would have granted certiorari in *Madden v. Gluck*, 815 F.2d 1163 (8th Cir.), *cert. denied*, 108 S. Ct. 86 (1987) where the Eighth Circuit reaffirmed its multiple schemes position on the pattern requirement. But certiorari was denied in *Madden v. Gluck* on October 6, 1987.⁵

⁴ For example, the criminal activities in *United States v. Ianniello*, 808 F.2d 184 (2d Cir. 1986) involving skimming profits from several different restaurants and bars owned by different corporate entities, which the Second Circuit characterized as a single "scheme", might well have been regarded by another court as "multiple schemes". Regardless of the characterization, the facts clearly met the "continuity" test, and the result would be the same in any circuit. As the Second Circuit said in *Beck*, citing *Ianniello*: "whether one looks for the requisite continuity and relatedness by examining the pattern or the enterprise is really a matter of form, not substance" (37A).

⁵ In light of this denial, petitioners appear to have abandoned their theory that any potential conflict with the Eighth Circuit decision on pattern provides a basis for review, instead reformulating the question to be whether the Second Circuit's enterprise holding "comports with the statutory definition of 'enterprise' in § 1961(4), and is within the ambit of footnote 14" (Supp. Brief 2).

III. The Second Circuit ruling on "enterprise" does not conflict with other circuits, *Sedima* or the statute.

Petitioners complain that "the rules of the Second and Fifth Circuits, in which 'pattern' litigation has segued into 'pattern/enterprise' litigation are grossly violative of the RICO statute and substantially transcend the possible limits of any mandate on the interpretation of 'pattern' suggested by this Court in [*Sedima*] footnote 14" (Petition 7).

Before turning to petitioners' substantive contentions on "enterprise", two preliminary points should be made. First, there is no conflict among the circuits on the interpretation of "enterprise". Petitioners repeatedly acknowledge (Petition 7, 15; Second Supp. Brief 2, 4, 6) that the Second and Fifth Circuits have taken the same approach on the enterprise question, and no circuit has expressed a conflicting view. Second, petitioners' frequent references to "pattern/enterprise litigation" is misleading, because pattern and enterprise are separate and different statutory elements and must be treated independently. As this Court said in *United States v. Turkette*, 452 U.S. 576, 583 (1981):

While the proof used to establish these separate elements may in particular cases coalesce, proof of one does not necessarily establish the other. The "enterprise" is not the "pattern of racketeering activity"; it is an entity separate and apart from the pattern of activity in which it engages. The existence of an enterprise at all times remains a separate element which must be proved by the Government.

Petitioners' substantive objection to the Second Circuit's decision in this case is that the lower court "violated the RICO statute and transcended the limits of footnote 14 of *Sedima* by appending to the concept of 'enterprise' *Sedima*'s continuity considerations regarding 'pattern'" (Petition 15). The argument is without merit.

The Second Circuit's requirement of continuity as an element of "enterprise" is fully consistent with this Court's

decision in *United States v. Turkette*, *supra*, where the Court said that enterprise is "proved by evidence of an *on-going organization*, formal or informal, and by evidence that the various associates function as a *continuing unit*" (452 U.S. at 583; emphasis supplied). There is no inconsistency whatever between the requirement of continuity for an enterprise, recognized in *Turkette* and in the decisions of the Second and Fifth Circuits, and the requirement of continuity in pattern, recognized in *Sedima* footnote 14 and in all of the decisions following *Sedima*.

Other circuits have reached similar holdings on the requirement of continuity for an enterprise. See, e.g., *United States v. Neapolitan*, 791 F.2d 489, 499-500 (7th Cir.), *cert. denied*, 107 S. Ct. 422 (1986) (following *Turkette*, the enterprise must be a distinct entity with a structure which is more than a group of people who get together to commit a pattern of racketeering activity); *United States v. Bledsoe*, 674 F.2d 647, 660-67 (8th Cir.), *cert. denied sub nom. Phillips v. United States*, 459 U.S. 1040 (1982) (holding that it is fundamental that the enterprise function as a continuing unit, requiring some continuity of structure and personnel); *United States v. Lemm*, 680 F.2d 1193, 1201 (8th Cir. 1982), *cert. denied*, 459 U.S. 1110 (1983) (sporadic and temporary criminal alliance to commit RICO crimes not sufficient to constitute an enterprise); *United States v. Riccobene*, 709 F.2d 214, 221-24 (3d Cir.), *cert. denied sub nom. Ciancaglini v. United States*, 464 U.S. 849 (1983) (ongoing organization required); *United States v. Zang*, 703 F.2d 1186, 1193-94 (10th Cir. 1982), *cert. denied sub nom. Porter v. United States*, 464 U.S. 828 (1983) (same).

The legislative history of RICO reveals that the continuity and relationship tests are not solely confined to the pattern requirement, and are integral to the enterprise requirement. For example, Rep. Poff's comment, quoted in *Sedima*, that RICO "is not aimed at the isolated offender" is addressed to the entire RICO statute, not just to the pattern requirement. 116 Cong. Rec. 35,193 (1970). Senator McClellan, one of the bill's sponsors, made clear that the prime focus of the bill was

enterprises with a coherent structure, *i.e.*, "organized crime groups", with defined "internal organization[s]" including "chieftains" and a "leadership structure" akin to a "private government". He said that the groups' operating methods had evolved "during several decades" of this century. 116 Cong. Rec. 585-86 (1970). Senator Hruska, the bill's co-sponsor, confirmed that "racket enterprises" were closely akin to the major organized crime families. *Id.* at 601. He stated that their actions are "the result of intricate conspiracies carried on over many years". *Id.* Likewise, Senator Scott stated that the bill was aimed at "syndicated crime" — which "involves thousands of criminals in structures as complex and large as any corporation with laws rigidly enforced through terror . . . [i]ts operations are national and international." *Id.* at 819. *See also id.* at 844. Throughout the debate, the legislators used "enterprise" to mean an organized structure such as a business. 116 Cong. Rec. 35,196-97 (1970). *See also id.* at 35,199, 35,201; Senate Report at 78-82.

The existing policy of the United States Attorney's Office also has incorporated considerations of continuity into the enterprise requirement. The United States Attorney's Manual instructs:

No RICO count of an indictment shall charge the enterprise as a group associated in fact, unless the association-in-fact has an ascertainable structure which exists for the purpose of maintaining operations directed toward an economic goal, that has an existence that can be defined apart from the commission of the predicate acts constituting the patterns of racketeering activity.

United States Attorney's Manual, Title 9—Criminal Division, Guideline No. 9-110.360. *See Montesano v. Seafirst Commercial Corp.*, 818 F.2d 423, 427 n.1 (5th Cir. 1987).

In their Second Supplemental Brief, having revised their statement of the grounds on which certiorari should be granted for the third time, petitioners now seek summary reversal under Supreme Court Rule 23.1. No basis exists on the record of this

case for such an extraordinary measure. Nor do petitioners, apart from their bald assertion that the decision of the Second Circuit is "judicial interpretation run amok" (Second Supp. Brief 4) offer a single credible ground upon which such a request could be granted.

Petitioners' contention that the group of law firms, individuals and a bank in this case whose common activity related to the public auction of certain trust assets — "one straightforward, short-lived goal" (37A) — constituted an "enterprise" finds no support in logic, the statute or the case law. The holdings of this Court in *Turkette* and of the Second Circuit and other circuits in numerous decisions all demonstrate that the element of continuity is essential to the statutory term "enterprise".

Finally, since petitioners attribute the Second Circuit's error of "engrafting" pattern considerations into the concept of enterprise to the decision in *United States v. Ianniello*, 808 F.2d 184 (2d Cir. 1986), *cert. denied*, 107 S. Ct. 3230 (1987), one might consider that case a more appropriate candidate for review by this Court than *Beck*. But this Court denied certiorari in *Ianniello*.

IV. There are currently pending before Congress amendments to RICO which would render-moot any conflict on the pattern requirement.

The proposed amendment to the RICO statute's definition of pattern currently before Congress (H.R. 3240),⁶ the most

⁶ The text of the amended definition of pattern proposed in H.R. 3240 is as follows:

Sec. 3-DEFINITION OF PATTERN.

Paragraph (6) of section 1961 of title 18, United States Code, as redesignated by section 2(b) of this Act, is amended to read as follows:

"(6) 'pattern' means at least two acts of racketeering activity or fraudulent activity, or both, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity or fraudulent activity, or both, that are—

recent in a series of legislative proposals since this Court's decision in *Sedima*, provides an additional basis upon which certiorari should be denied. Even in the face of a square conflict, certiorari is inappropriate where the statute upon which the controversy rests may be amended in a manner which will prevent the problem from arising in future cases. *United States v. Abrams*, 344 U.S. 855 (1952); *Community Services, Inc. v. United States*, 342 U.S. 932 (1952); *Sokol Bros. Furniture Co. v. Commissioner*, 340 U.S. 952 (1951); *United States v. Beal*, 340 U.S. 852 (1950); *United States v. Wilkinson*, 355 U.S. 839 (1957); *United States Rubber Co. v. Commissioner*, 274 F.2d 307 (2d Cir.), cert. denied, 363 U.S. 827 (1960).

"(A) under subsection 1962(c) of this chapter, related to the affairs of an enterprise;

"(B) not isolated, but they need not be part of a common scheme or plan; and

"(C) except under section 1962(b) of this chapter, not so closely related to each other and connected in point of time and place that the acts constitute a single episode involving only one victim so that they do not in themselves, in light of the purpose for which they were committed, with reference to the enterprise, or otherwise, give rise to an inference of the possibility of continuity of activity;".

CONCLUSION

The Second Circuit's decision in this case presents no issue worthy of review by this Court. Accordingly, respondents respectfully request this Court to deny the petition for a writ of certiorari.

Dated: December 11, 1987

Respectfully submitted,

ADLAI S. HARDIN, JR.

1 Chase Manhattan Plaza

New York, N.Y. 10005

(212) 530-5000

Attorney for Respondents

Of Counsel:

ANDREW CITRON

JOANN CRISPI

MILBANK, TWEED, HADLEY & McCLOY

1 Chase Manhattan Plaza

New York, N.Y. 10005

(212) 530-5000

DEC 24 1987

No. 87-616

JOSEPH F. SPANIOL, JR.
CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1987

HUBERT PARK BECK, DOROTHY FAHS BECK,
ROBERT J. BECK and OTTO WEINMANN,
Petitioners,

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Respondents.

REPLY TO OPPOSITION TO
PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

STUART HECKER, ESQ.
Attorney for Petitioners
521 Fifth Avenue
New York, New York 10175
(212) 682-7070

PUBLISHER'S NOTE:

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PRELIMINARY STATEMENT

In their brief respondents offer four arguments in opposition to the granting of a writ of certiorari: (1) the Second Circuit's "enterprise" rule does not conflict with that of other circuits; (2) the conflict among the circuits on "pattern" does not merit review at this time; (3) Congress is considering legislation which would render moot any conflict regarding "pattern"; and (4) this case is inappropriate for review by this court because it does not involve any clearly definable criminal conduct. Each of these contentions will be addressed.

At the outset, however, two preliminary matters must be briefly discussed: (1) respondents' omission of any analysis of the statutory language, and (2) petitioners' standing to plead the allegations set forth in Phase III of the amended complaint — respondents' role in the defrauding of the government and people of Mexico.

1. The Statutory Language

It is axiomatic that the starting point for the construction of a statute must be its words. "In determining the scope of a statute, we look first to its language. If the statutory language is unambiguous, in the absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.'" *United States v. Turkette*, 452 U.S. 576, 580 (1981), citing *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

Petitioners have argued that the "single-purpose scheme" rule of courts such as the Fourth and Tenth Circuits, which preclude a "pattern" in the case of a single-purpose scheme that had terminated at the inception of the action, is in direct contradiction of §1962(b),

which expressly contemplates the existence of a "pattern" in such circumstances. And, since Congress enacted only one standard for "pattern" in §1961(5), which is equally applicable to all of the subsections of §1962, the "single-purpose scheme" rule must be violative of §§ 1962(a), (c), and (d) as well. Finally, the "single-purpose enterprise" rule of the Second and Fifth Circuits, which is dependent on "pattern" considerations but goes beyond them because "enterprise" as defined in §1961(4) is not susceptible of similar judicial interpretation, is violative of all of the subsections of §1962 for the same reasons.

Nowhere in their brief do respondents attempt to provide an answer to this argument. Only one conclusion can be drawn from this: they have none.

- 2. Petitioners' standing with respect to Phase III

Respondents assert, without the citation of any authority, that petitioners, "[who] do not represent or act as ombudsmen for the Mexican Government or people, ... have no standing to maintain the Phase III claim and the federal courts have no jurisdiction to entertain it" (Brief in Opp. at 3). Petitioners' standing with respect to the Phase III allegations is not an issue on this petition. However, this Court should be aware that respondents argued extensively against such standing before the courts below, and that both the District Court (645 F. Supp. at 681-82) and Second Circuit (820 F. 2d at 50-51) rejected their position, holding that petitioners' Phase III allegations stated a claim under Fed. R. Civ. P. 12(b)(6).

REPLY TO RESPONDENTS' SUBSTANTIVE ARGUMENTS

1. The conflicts among the circuits regarding "enterprise."

Respondents' argument regarding "enterprise" is obfuscatory. The circuits may, as respondents assert, be in general agreement as to the *nature* of "enterprise," but only the Second and Fifth Circuits have adopted the *rule* that a single-purpose enterprise that is not open-ended cannot be a RICO enterprise within the meaning of §1961(4). No circuit other than the Second and Fifth would, after having reversed the District Court by holding that petitioners had adequately pled a "pattern," have held that they had not pled an "enterprise."

Contrary to respondents' contention, *United States v. Turkette* (*supra*) provides no support for the "single-purpose enterprise" rule. *Turkette* merely holds that the definition of "enterprise" in §1961(4) includes both legitimate and illegitimate enterprises within its scope.

Turkette actually undermines respondents' position, recognizing that the definition of "enterprise" must be read expansively, since "Section 904(a) of RICO, ... directs that 'the provisions of this Title shall be liberally construed to effectuate its remedial purposes....'" 452 U.S. at 587. Despite the fact that Reps. Eckhardt and Mikva (among others) are cited as having been chary of sweeping areas of state criminal law into the Federal realm (*Id.*), "[t]he language of the statute, ... — the most reliable evidence of its intent — reveals that Congress opted for a far broader definition of the word 'enterprise,' and we are unconvinced by anything in the legislative history that this definition should be given less than its full effect." *Id.* at 593.

All *Turkette* requires for proof of an "enterprise" is "evidence of an ongoing organization, formal or informal, and ... evidence that the various associates function as a continuing unit." *Id.* at 583. This requirement is fully complied with by the amended complaint, and nothing in the Second Circuit opinion gives rise to a contrary conclusion.* The "single-purpose enterprise" rule, which transforms *Turkette*'s "continuing unit" requirement into a condition that the enterprise be open-ended and in existence at the institution of the action, comes not from *Turkette*, but from the Second Circuit's own reading of the statute.

2. The conflicts among the Circuits regarding "pattern."

Respondents attempt, by picking language out of the opinions, to harmonize *Barticheck v. Fidelity Union Bank/First National State*, No. 86-5870, slip op. (3rd Cir. October 29, 1987), 56 U.S.L.W. 2260 (November 10, 1987) (to be reported at 832 F. 2d 36; Appendix P), with *Eastern Publishing and Advertising, Inc. v. Chesapeake Publishing and Advertising, Inc.*, No. 87-1520, slip op. (4th Cir. October 16, 1987) (to be reported at 831 F. 2d 488; Appendix O), and *Garbade v. Great Divide Mining and Milling Corp.*, No. 86-2544, slip op. (10th Cir. October 15, 1987) (to be reported at 831 F. 2d 212; Appendix N).

* Indeed, as is set forth in the petition for certiorari, the Second Circuit's holding that the amended complaint adequately pled a "pattern" was necessarily predicated, under Second Circuit precedent, on its proper allegation of an "enterprise." Cf., *United States v. Ianniello*, 808 F. 2d 184 (2d Cir. 1986), *cert. denied*, 107 S. Ct. 3230 (1987); *United States v. Weisman*, 624 F. 2d 1118 (2d Cir.), *cert. denied*, 449 U.S. 871 (1980).

But no amount of selective culling can avoid the diametrically opposed *holdings* in those cases, which were decided within two weeks of each other: *Barticheck* expressly rejects the "single-purpose scheme" rule for pattern; *Eastern Publishing* and *Garbade* embrace it. It is clear that, had *Eastern Publishing* and *Garbade* been brought in the Third Circuit, the plaintiffs would have prevailed in each case.

In rejecting the "single-purpose scheme" rule for pattern the Third Circuit pointed out that the notion that "continuity" requires "open-endedness" would produce anomalous results: "This approach would allow a party to maintain a RICO claim if he brought suit before the unlawful scheme had attained its objective; in such a case the scheme would presumably be considered open-ended. The same interpretation, though, would deny a RICO cause of action in a case where the scheme had fully accomplished its goal. Yet it is the completed scheme that inflicts the greater harm and more strongly implicates the remedial purposes of RICO." *Barticheck*, 56 U.S.L.W. at 2260, slip op. at 8-9; Appendix P at 162A. Respondents do not refer to this observation by the Court, much less provide an answer to it.

Respondents denounce petitioners' claims regarding the chaotic state of "pattern" litigation as "highly exaggerated." Brief in Opp. at 4-5. But a review of the existing situation makes it clear that the appellation is warranted:

The Eighth Circuit has taken a very restrictive view of "pattern," requiring at least two fraudulent schemes for its existence. *Superior Oil Co. v. Fulmer*, 785 F. 2d 252, 257

(8th Cir. 1986).^{*} The First Circuit has also taken a restrictive approach, and while implicitly critical of *Superior Oil*, has left open whether it would adopt the "multiple-schemes" rule. *Roeder v. Alpha Industries, Inc.*, 814 F. 2d 22, 31-32 (1st Cir. 1987).

The Seventh Circuit has adopted a pragmatic, case-by-case approach to "pattern." *Morgan v. Bank of Waukegan*, 804 F. 2d 970, 975 (7th Cir. 1986). Similar pragmatic approaches have been taken by the Fourth Circuit (*International Data Bank, Ltd. v. Zepkin*, 812 F. 2d 149, 154 (4th Cir. 1987)), and the Eleventh Circuit (*Bank of America v. Touche Ross & Co.*, 782 F. 2d 966, 971 (11th Cir. 1986)). The similarity of approach is belied by the profound differences in result, however. The application by the Eleventh Circuit is far more liberal than that of the Seventh; in the latter, a lengthy line of "no-pattern" rulings has developed alongside *Morgan*, at least some of which would appear to satisfy the "pattern" requirements of *Bank of America*. And neither the Seventh nor the Eleventh Circuit recognizes the "single-purpose scheme" rule recently adopted by the Fourth in *Eastern Publishing and Advertising, Inc., v. Chesapeake Publishing and Advertising, supra*.

The Tenth Circuit, while rejecting the "multiple schemes" test, has taken a restrictive approach to

* As is pointed out in both the petition for certiorari and respondents' brief in opposition, two judges in *H.J., Inc. v. Northwestern Bell Telephone Co.*, 829 F. 2d 648 (8th Cir. 1987), while recognizing the controlling authority of *Superior Oil*, indicated in concurring opinions that the "multiple schemes" rule should be reexamined by the Court *en banc*. But that is not tantamount to a reversal; the solidity of the "multiple schemes" rule is attested to by a long and unvarying line of Eighth Circuit cases. *See*, Petition at 13.

"pattern" (*Condict v. Condict*, 815 F. 2d 579 (10th Cir. 1987); *Torwest DBC, Inc. v. Dick*, 810 F. 2d 925 (10th Cir. 1987)), and has added to the restrictiveness by adopting the "single-purpose scheme" rule (*Garbade v. Great Divide Mining & Milling Corp.*, *supra*).

The Ninth Circuit has taken a relatively liberal approach to "pattern" (*Televideo Systems, Inc. v. Heidenthal*, 826 F. 2d 915 (9th Cir. 1987)), but appears to have implicitly superimposed the "single-purpose scheme" rule (*Sun Savings & Loan Association v. Dierdorff*, 825 F. 2d 187 (9th Cir. 1987); *Schreiber Distributing Co. v. Serv-Well Furniture Co.*, 806 F. 2d 1393 (9th Cir. 1986)).

The Third Circuit has adopted a liberal reading of "pattern," and has expressly rejected the "single-purpose scheme" rule. *Bariicheck v. Fidelity Union Bank/First National State*, *supra*.

The Second and Fifth Circuits have adopted the most liberal "pattern" rules of all. *United States v. Ianniello*, *supra*; *R.A.G.S. Couture, Inc. v. Hyatt*, 774 F. 2d 1350, 1355 (5th Cir. 1985). Alone among the Circuits, however, they adhere to the "single-purpose enterprise" rule. *Beck; Furman v. Cirrito*, 828 F. 2d 898 (2d Cir. 1987); *Albany Insurance Co. v. Esses*, No. 86-7968, slip op. (2d Cir. October 15, 1987) (Appendix M); *Montesano v. Seafirst Corp.*, 818 F. 2d 423, 426-27 (5th Cir. 1987).

From the foregoing, "chaos" appears to be an apt description of the current state of "pattern" litigation in the Federal Courts.

3. Pending Congressional legislation

Respondents argue that "even in the face of a square conflict [among the Circuits], certiorari is inappropriate

where the statute upon which the controversy rests may be amended in a manner which will prevent the problem from arising in future cases." Brief in Opp. at 12. This proceeds from a notion, based upon the separation of powers, that courts should abstain from precipitous insinuation into the legislative province where a legislative body gives evidence of attempting, by statutory amendment, to cure its ~~improvident~~ act. But such abstention is totally inappropriate where, as here, the amendatory legislation is necessitated not by legislative improvidence, but by judicial misapplication of the original statute. In such case the improper judicial encroachment has already occurred, and should be extirpated as quickly as possible. The same considerations that give rise to abstention in the former case militate toward direct and immediate remedial judicial action in the latter. It is respectfully submitted that this Court should take such action by granting the petition for certiorari.

4. The conduct of defendants

Respondents argue that this is a poor case for review on certiorari, because "the amended complaint does not allege any racketeering activity" (Brief in Opp. at 3), and that "neither of the lower courts was able to identify any comprehensible factual allegations of fraud in the amended complaint" (*Id.* at 4).

These assertions are absurd on their face, given the

* For the sake of completeness the Court should be apprised that petitioners are aware of two bills pending in Congress that would amend RICO that were not cited by respondents. These are HR 2983, introduced by Rep. Boucher (D-Va.), and its Senate counterpart, S1523, introduced by Sen. Metzenbaum (D-Ohio). So far as petitioners are aware, neither of these bills would amend the definition of "pattern" contained in the current statute.

holding of the District Court that the allegations of Phases II and III of the amended complaint state a RICO claim under Rule 12(b)(6) (645 F. Supp. at 681-82), and the holding of the Second Circuit that the allegations of Phases II and III adequately plead a RICO "pattern" (820 F. 2d at 50-51). In order for this Court to arrive at its own independent judgment as to the nature and gravity of respondents' conduct, however, the amended complaint (with annexed exhibits that substantially document its allegations) has been reproduced as Appendix R.

Respectfully submitted,

Stuart Hecker
Attorney for Petitioners
521 Fifth Avenue
New York, New York 10175
(212) 682-7070

APPENDIX R
AMENDED COMPLAINT

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

HUBERT PARK BECK, DOROTHY FAHS
BECK, ROBERT J. BECK and OTTO
WEINMANN,

Plaintiffs,

-against-

MANUFACTURERS HANOVER TRUST
COMPANY; MILBANK, TWEED, HADLEY
& McCLOY; KELLEY DRYE & WARREN;
DONALD B. HERTERICH; ISAAC
SHAPIRO; and EDWARD ROBERTS, III,

Defendants.

85 Civ. 9361 (RWS)

AMENDED COMPLAINT

Jury Trial Demanded

Plaintiffs, for their amended complaint, respectfully
allege as follows:

1. This case is brought under the Racketeer Influenced
and Corrupt Organizations Act ("RICO"), 18 U.S.C. §1961
et seq. The jurisdiction of this Court is invoked pursuant
to 18 U.S.C. §1964(c).

2. Defendant Manufacturers Hanover Trust

Company ("Manufacturers") is a corporation organized under the laws of the State of New York, with its principal office in the City of New York.

3. Defendant Milbank, Tweed, Hadley & McCloy ("Milbank") is a partnership organized under the laws of the State of New York, with its principal office in the City of New York.

4. Defendant Kelley Drye & Warren ("Kelley") is a partnership organized under the laws of the State of New York, with its principal office in the City of New York.

5. Defendant Donald B. Herterich ("Herterich") is, and has been at the relevant times set forth herein, a Senior Vice-President of Manufacturers.

6. Defendant Isaac Shapiro ("Shapiro") is, and has been at the relevant times set forth herein, a partner in Milbank.

7. Defendant Edward Roberts, III ("Roberts") is, and has been at the relevant times set forth herein, a partner in Kelley.

8. Plaintiffs are the owners of defaulted bearer bonds (collectively, the "Bonds") of two related senior series of the National Railway Company of Mexico ("National"), a Utah corporation. In the aggregate, they own \$1,500 in principal amount of 4-1/2% Prior Lien Gold Bonds, dated March 15, 1902 and due on October 1, 1926 (the "Prior Lien Bonds"); and \$153,500 in principal amount of 4% Gold Bonds, due October 1, 1951 (the "Consolidated Mortgage Bonds"). The initial issue of the Prior Lien Bonds totalled \$23,000,000 in principal amount; that of the Consolidated Mortgage Bonds totalled \$27,289,000 (although 30,000,000 had been authorized).

9. Manufacturers is the successor trustee under the indentures pursuant to which the Bonds were issued.

Summary of allegations

10. Plaintiffs allege that defendants violated RICO (i) by defrauding and conspiring to defraud plaintiffs and similarly situated Bond holders of principal and interest on the Bonds and the value of collateral held by Manufacturers as trustee; and (ii) by defrauding and conspiring to defraud The United States of Mexico ("Mexico") of the value of such collateral. This is not a class action; plaintiffs do not purport to represent any Bond holders other than themselves.

11. This is a companion case to two cases pending in the Supreme Court of New York County: *Beck, et al. v. Manufacturers Hanover Trust Company*, Index No. 12896/83 ("Beck I"); and *Beck, et al. v. Manufacturers Hanover Trust Company*, Index No. 15145/85 ("Beck II").

12. In *Beck I* Manufacturers is alleged to have engaged in fraud and to have breached its fiduciary responsibilities to plaintiffs, as Bond holders, in its administration of the indenture trust. In *Beck II* Manufacturers is alleged to have breached its fiduciary responsibilities to plaintiffs as Bond holders in the conduct of its defense in *Beck I*. Compensatory and punitive damages have been demanded in both actions, which have been assigned to the individual calendar of Hon. Martin Evans; Milbank and Kelley are co-counsel for Manufacturers in both actions.

13. This amended complaint contains ten counts. Each of the counts encompasses racketeering activity, as defined in 18 U.S.C. §1961(1), involving three phases of such activity in the administration of the trust. The first phase includes seven distinct episodes of unlawful

conduct, the second two, and the third three; the episodes constituting each phase are alleged to satisfy alone any judicial requirement of continuity for a pattern of racketeering activity under 18 U.S.C. §1961(5). The predicate acts alleged involve violations of 18 U.S.C. §1341 (relating to mail fraud), and 18 U.S.C. §1343 (relating to wire fraud). Plaintiffs do not at this time allege a pattern of racketeering activity referable to each such phase or episode for each defendant on each count.

14. The phases of unlawful activity alleged by plaintiffs are the following:

(i) Phase I: the defrauding of plaintiffs and similarly situated holders of Prior Lien Bonds by unlawfully treating Mexico as a holder of those bonds with respect to seven distributions of accrued interest from April 1, 1972 through December 31, 1981. Through this treatment defendants wrongfully permitted more than ninety percent of each such distribution to be siphoned off to Mexico, to the detriment of plaintiffs and other individual holders of Prior Lien Bonds;

(ii) Phase II: the defrauding of plaintiffs and similarly situated holders of both series of Bonds of substantially the entire value of the collateral held by Manufacturers as indenture trustee through (a) the sale of the collateral at a fraudulently low price, and (b) the treatment of Mexico as a Bond holder entitled to 95.83% of the fraudulently low proceeds of the sale;

(iii) Phase III: the defrauding of the government and people of Mexico of their purported share of the proceeds of the sale of collateral through (a) the sale of the collateral at a fraudulently low price; (b) the failure to disclose to the government of Mexico that it was being defrauded by corrupt Mexican nationals, some of whom

were government officials, and that Mexico could have appeared at the sale and purchased the collateral for little or no cash outlay; and (c) the acceptance from the purchaser by Manufacturers, in payment of 95.83% of the sale price, of a fraudulent and legally ineffective assignment, given without consideration, of Prior Lien Bonds previously recognized by Manufacturers as validly held by Mexico.

15. Count One, against all six defendants, alleges that they violated 18 U.S.C. §1962(c) by their membership in an association-in-fact which constituted an enterprise within the meaning of 18 U.S.C. §1961(4), and by their conduct of the affairs of that enterprise through a pattern of racketeering activity involving the foregoing episodes of unlawful conduct.

16. Count Two, against Herterich, Shapiro, and Roberts, alleges that those defendants violated 18 U.S.C. §1962(c) by conducting the affairs of the respective enterprises of Manufacturers, Milbank, and Kelley through such pattern of racketeering activity.

17. Count Three, against Manufacturers, Milbank, and Kelley, alleges that those defendants violated 18 U.S.C. §1962(a) by receiving income from the foregoing pattern of racketeering activity, and investing part of the proceeds of such income in (i) the establishment and operation of the enterprise consisting of the association-in-fact of the six defendants, and/or (ii) the operation of the enterprises of, respectively, Manufacturers, Milbank, and Kelley.

18. Count Four, against all six defendants, alleges that they violated 18 U.S.C. §1962(b) by acquiring and/or maintaining, through a pattern of racketeering activity, an interest in and/or control of the enterprise consisting

of the association-in-fact of the six defendants.

19. Count Five, against Herterich, Shapiro, and Roberts, alleges that they violated 18 U.S.C. §1962(b) by maintaining, through a pattern of racketeering activity, an interest in and/or control of the enterprises of, respectively, Manufacturers, Milbank, and Kelley.

20. Counts Six through Ten, against all six defendants, collectively allege that defendants violated 18 U.S.C. §1962(d) by conspiring to commit the violations of 18 U.S.C. §§1962(a), (b), and (c) set forth in Counts One through Five.

Underlying allegations

21. As security for the debt evidenced by the Bonds, National transferred certain property (the "collateral") to defendant's predecessor trustee. The Prior Lien Bonds represented a first mortgage against the collateral, the Consolidated Mortgage Bonds a second. The collateral included the following:

(i) All of the authorized and outstanding shares of the \$100 par value capital stock of Texas-Mexican Railway Company ("Tex-Mex");

(ii) A substantial amount of real property, most of it in Laredo, Texas, some of which was owned by National and leased to Tex-Mex, the balance of which was owned by Tex-Mex;

(iii) U.S. \$960,000 in aggregate principal amount of Corpus Christi, San Diego & Rio Grande Narrow-Gauge Railroad Company 7% bonds due July 1, 1910;

(iv) U.S. \$1,380,000 in aggregate principal amount

of Tex-Mex 6% bonds due July 1, 1921; and

(v) That portion of the International Railroad Bridge between Nuevo Laredo (in Mexico) and Laredo, Texas, which is in the United States.

22. Pursuant to a Plan of Readjustment and Union, dated April 6, 1908 (the "1908 Plan"), Ferrocarriles Nacionales de Mexico ("Ferrocarriles"), a Mexican corporation, acquired the stock of National and the stock and bonds of Mexican Central Railway Company, Limited ("Central"), a Massachusetts corporation. On information and belief a majority of the stock of Ferrocarriles has always been owned by the government of Mexico.

23. The 1908 Plan called for the shareholders of National and the shareholders and bondholders of Central to deposit their securities with various enumerated depositories, to be exchanged for securities of Ferrocarriles. The 1908 Plan did not call for the deposit of National's outstanding bonds, among which are the Bonds. Under the 1908 Plan Ferrocarriles became the guarantor of National's obligations to pay interest and principal on the Bonds.

24. Pursuant to decrees dated November 25, 1936, and June 24 and June 25, 1937, National was purportedly nationalized by Mexico, and all of its assets transferred to an autonomous bureau of the Mexican government. On April 30, 1938 Mexico created the National Labor Administration of Railways, another government agency, to which, to the extent that the nationalization decrees were lawful, the ownership of National and other nationalized railroads were assigned. On December 31, 1940, all of the rights, obligations, and property of the National Labor Administration of Railways, including the purported ownership of National, were transferred to and assumed

by the Administration of the National Railways of Mexico, another agency of the Mexican government.

25. By its ownership of Ferrocarriles and its nationalization decrees Mexico became, with respect to the obligations owed to the holders of the Bonds, an effective legal issuer of the Bonds.

26. National defaulted on interest payments on the Bonds in 1914. It defaulted on principal on the Prior Lien Bonds when they became due on October 1, 1926, and on the Consolidated Mortgage Bonds when they became due on October 1, 1951. On information and belief none of such defaults was ever cured by Ferrocarriles.

27. On information and belief the aggregate amount of principal and accrued interest owing to plaintiffs on their Bonds is approximately \$4,000,000 at the present time.

28. Manufacturers subsequently began, as trustee, to make sporadic distributions on account of accrued and unpaid interest on the Prior Lien Bonds. Thirteen such distributions were made, seven of which occurred after October 15, 1970, the effective date of RICO. These seven distributions represent the episodes of unlawful activity comprising Phase I of the racketeering activity alleged to have been engaged in by defendants. A schedule of such distributions, as reported by Manufacturers, follows:

| <u>Date</u> | <u>Distribution of accrued interest as a percentage of principal amount</u> |
|----------------|---|
| Dec. 14, 1942 | 1 |
| Sept. 17, 1945 | 1 |
| Dec. 26, 1951 | 4 |
| Apr. 28, 1954 | 3 1/2 |

| | |
|---------------|-------|
| Apr. 30, 1957 | 2 |
| Apr. 15, 1965 | 5 |
| Apr. 1, 1972 | 5 |
| May 15, 1975 | 1 1/2 |
| Apr. 1, 1977 | 3 1/2 |
| Dec. 15, 1978 | 1 |
| Dec. 15, 1979 | 2 |
| Dec. 15, 1980 | 1 |
| Dec. 31, 1981 | 23 |

Manufacturers also made one small distribution of interest, in 1953, on the Consolidated Mortgage Bonds. No payment or distribution of principal had ever been made on the Bonds prior to 1982.

A. Phase I

29. In 1946 Mexico embarked on a program looking toward the redemption of several series of defaulted bonds (including the Bonds), of corporations doing business in Mexico or which it deemed to be owned by Mexico. It entered into an Agreement, dated February 20, 1946 (the "1946 Agreement"), with an "International Committee of Bankers on Mexico" (the "International Committee"), pursuant to which assenting holders of the Bonds could surrender them to Mexico in accordance with two plans (Plan A and Plan B); these plans called for scaled-down payments of principal and interest to the assenting Bond holders. The Administration of the National Railways of Mexico, as the owner of National, was a party to the 1946 Agreement.

30. The International Committee was self-constituted and self-appointed, and did not have any authority with respect to the Bonds except that conferred by assenting holders (none of whom is a plaintiff in this action or, on information and belief, a previous holder of any of

plaintiffs' Bonds).

31. Provisions of the 1946 Agreement required that Bonds tendered pursuant to Plan A or Plan B ("assenting Bonds") had to be "redeemed" pursuant to schedules, and then "retired" upon redemption. Mexico was required to complete its payment obligations to the assenting Bond holders by January 1, 1975 at the latest; thus, by that time, all assenting Bonds were to have been retired by Mexico.

32. The 1946 Agreement was implemented by an offer contained in a registration statement filed by Mexico on April 24, 1948 (as amended to 1954) with the United States Securities and Exchange Commission. In a prospectus contained in that registration statement Mexico undertook to retire all assenting Bonds (whether under Plan A or Plan B) in accordance with the schedules set forth in the 1946 Agreement.

33. The vast majority of Bonds were tendered in accordance with the 1946 Agreement. Mexico also acquired some Bonds through purchases in the open market prior and subsequent to the 1946 Agreement.

34. By November 1, 1982, and on information and belief much earlier, Mexico had acquired, through tender and purchase, 95.83% of all Prior Lien Bonds and 95.50% of all Consolidated Mortgage Bonds.

35. Mexico did not retire any of the Bonds, whether acquired through tender or purchase. Instead, it continued to hold them, claiming itself to be a *bona fide* holder entitled to all of the rights and privileges of the holders of non-assenting Bonds.

36. Manufacturers, as trustee, was under a fiduciary

obligation to enforce the 1946 Agreement on behalf of the non-assenting Bond holders; accordingly, it should have treated the assenting Bonds tendered to Mexico pursuant thereto as having been retired, or taken steps to have them declared to have been retired.

37. Manufacturers should also have treated as retired the Bonds acquired by Mexico through open-market purchases, since Mexico, through its ownership of Ferrocarriles and its nationalization decrees, had become an effective legal issuer of the Bonds (¶¶ 22-25, *supra*). An issuer of defaulted bonds which has purchased some of such bonds for a fraction of their face value must, as a matter of law, treat them as retired. It may not claim to be a holder of such bonds with the same entitlement as public bond holders to participate in distributions of principal and interest.

38. Manufacturers was fully aware that a substantial number of Bonds had been tendered to Mexico pursuant to the 1946 Agreement. It also knew that Mexico had purchased some Bonds on the open market.

39. Nevertheless Manufacturers accepted Mexico's position that it was a holder on a theory that, as trustee, it "wears blinders," and was required, regardless of any extrinsic circumstances, to treat anyone in physical possession of any of the Bonds as the holder of those Bonds. Thus, with respect to the eleven interim distributions of interest made by Manufacturers as trustee subsequent to the effective date of the 1946 Agreement (¶ 28, *supra*), the portion allocated to the non-assenting Bond holders always reflected the treatment of the Bonds tendered to and purchased by Mexico as valid and outstanding. This was true even with respect to the six such distributions subsequent to January 1, 1975, by which date Mexico had fully discharged its obligations on the assenting Bonds

under the 1946 Agreement, and by which date all of such Bonds should have been retired in accordance with the 1946 Agreement and the implementing registration statement.

40. The lion's share of all of the interim distributions of interest thus went to Mexico; the interests of the non-assenting Bond holders were almost completely diluted by the treatment of Manufacturers, as trustee, of Mexico as a holder.

41. On information and belief Manufacturers' treatment of Mexico as a Bond holder was made possible through one or more of four "enterprises" within the meaning of 18 U.S.C. §1961(4); these enterprises, which existed and functioned continuously from at least October 15, 1970, the effective date of RICO, through at least November 29, 1982, the date on which the sale of the collateral held by Manufacturers was closed, were:

(i) Manufacturers;

(ii) Milbank;

(iii) Kelley; and

(iv) an association-in-fact consisting of Manufacturers; Kelley, its counsel; Milbank, counsel to Mexico; and the senior officers of Manufacturers and partners in the law firms who were primarily responsible for matters relating to and growing out of the administration of the trust.

42. The identities of the individual members of the association-in-fact varied from time to time. On information and belief:

(i) Herterich, as Senior Vice-President of Manufacturers, was a member continuously from at least October 15, 1970. His tenure thus spanned all of the episodes of unlawful conduct comprising each of the three phases of alleged racketeering activity set forth in ¶ 14, *supra*;

(ii) Shapiro was a member continuously from at least January 1, 1980. His tenure thus spanned at least the last two interest distributions in Phase I, and all of the episodes of unlawful conduct alleged in Phases II and III. Prior to Shapiro's advent, one or more other Milbank partners, none of whom is a defendant herein, were members;

(iii) Roberts was a member continuously from at least October, 1978. His tenure thus spanned at least the last four interest distributions in Phase I, and all of the episodes of unlawful conduct alleged in Phases II and III. Prior to Roberts' advent, one or more other Kelley partners, none of whom is a defendant herein, were members.

43. The functions of the enterprise of Manufacturers, Milbank, and Kelley were carried out, throughout the period beginning at least on October 15, 1970, not only through senior officers and partners, but also through a substantial number of lesser officers, associates, and support personnel.

44. On information and belief the purposes of the enterprises included the following:

(i) In Phase I, the defrauding of plaintiffs and similarly situated holders of Prior Lien Bonds by unlawfully treating Mexico as a holder of such bonds with respect to distributions of accrued interest on April 1, 1972; May 15, 1975; April 1, 1977; December 15, 1978; December 15, 1979; December 15, 1980; and December 31,

1981;

(ii) In Phase II, the defrauding of plaintiffs and similarly situated holders of both series of Bonds of substantially the entire value of the collateral held by Manufacturers as trustee through (a) the sale of the collateral at a fraudulently low price, and (b) the treatment of Mexico as a Bond holder entitled to 95.83% of the fraudulently low proceeds of the sale; and

(iii) In Phase III, the defrauding of the government and people of Mexico of their purported share of the proceeds of the sale of collateral through (a) the sale of the collateral at a fraudulently low price; (b) the failure to disclose to the government of Mexico that it was being defrauded by corrupt Mexican nationals, some of whom were government officials, and that Mexico could have appeared at the sale and purchased the collateral for little or no cash outlay; and (c) the acceptance from the purchaser by Manufacturers, in payment of 95.83% of the sale price, of a fraudulent and legally ineffective assignment, on information and belief given without consideration, of Prior Lien Bonds previously recognized by Manufacturers as validly held by Mexico.

45. On information and belief in order to attain the purposes of Phase I and Phase II the members of the association-in-fact developed the "blinders" theory — the notion that Manufacturers, as trustee, was absolutely required to recognize as valid and outstanding all Bonds presented for distributions of interest and principal, and was precluded from looking to extrinsic considerations that might have invalidated them for such distributions.

46. In accordance with the blinders theory the Prior Lien Bonds presented by Mexico were honored with respect to all eleven of Manufacturers' interim

distributions of interest subsequent to the effective date of the 1946 Agreement, and with respect to the proceeds of the sale of collateral. Thus Manufacturers allocated to Mexico 95.83% of the proceeds of the sale of collateral and of the December 31, 1981 interest distribution. It made similar allocations of the six interest distributions from April 1, 1972 through December 15, 1980, based upon the principal amount of Prior Lien Bonds in Mexico's possession at the respective times of such distributions. On information and belief Mexico was never allocated less than 90% of any such distribution and its allocation may have reached 95.83% long before the distribution of December 31, 1981. Thus, by means of the blenders theory, the non-assenting Bonds held by plaintiffs and others were diluted almost to non-existence.

47. On information and belief each member of the association-in-fact was fully familiar with the provisions of the 1946 Agreement and Mexico's 1948 registration statement requiring retirement of the Bonds tendered to Mexico pursuant to Plan A or Plan B. On information and belief each was also familiar with the legal principal that, apart from contract, an issuer which has acquired its defaulted bonds for a fraction of the principal and accrued interest owed on them must retire them; such an issuer may not profit from its default by according itself the status of a holder of those bonds to the pecuniary detriment of the public holders thereof.

48. Plaintiffs made clear to Manufacturers, on more than one occasion, that its treatment of Mexico as a holder was unlawful, and might result in liability. By letter dated October 18, 1978, the bank was informed by plaintiffs' then counsel that any payments of principal or interest to Mexico or its fiscal agent subsequent to the effective date of the 1946 Agreement were improper, and that it was under a duty as trustee to recapture any such payments

and apply them for the benefit of the holders of non-assenting Bonds. By letter dated January 2, 1979 Manufacturers was notified that since, at the very least, it was not clear that Mexico should be accorded the status of holder, the bank was under a fiduciary obligation to seek a declaratory judgment on the question. Manufacturers, however, did not seek a declaratory judgment, and continued to treat Mexico as a holder.

49. On information and belief each member of the association-in-fact was fully aware of plaintiffs' position with respect to Mexico's Bonds, and of plaintiffs' efforts to persuade Manufacturers to treat those Bonds as having been retired.

50. On information and belief the members of the association-in-fact attempted, through notices in connection with the interim distributions of interest, to disguise Manufacturers' treatment of Mexico as a Bond holder. In those notices Manufacturers purported to pay the portions of such distributions that it allocated to the assenting bonds not to Mexico but to The Chase Manhattan Bank ("Chase") as Fiscal Agent for Mexico under the 1946 Agreement. Provisions of the 1946 Agreement require the appointment of a Fiscal Agent to ensure compliance by Mexico with its obligations to the assenting Bond holders under Plan A and Plan B. Such obligations included the making of interest and sinking fund payments in accordance with the schedules in the Plans.

51. On information and belief Manufacturers mailed a notice of each of the seven interim interest distributions from April 1, 1972 through December 31, 1981 to all of the holders of non-assenting Prior Lien Bonds then on its records. (A photocopy of the notice received by plaintiff Hubert Park Beck in connection with the December 15, 1978 distribution is annexed hereto as Exhibit A.)

Manufacturers also, on information and belief, caused each such notice to be published in both the Wall Street Journal and The New York Times in advance of each such distribution.

52. The notices mailed and published in connection with all seven interim interest distributions are substantially identical to Exhibit A. Each of the notices contained the following statement:

In respect of Bonds which have been stamped to indicate assent to the Offer of the United States of Mexico made pursuant to Mexico's Agreement with the International Committee of Bankers on Mexico dated February 20, 1946, the amount of such distribution will be paid to The Chase Manhattan Bank, Successor Fiscal Agent of Mexico, in accordance with the Assignments provided for in Article IX of said Agreement; and distribution will not be made to the holders of such assenting Bonds. (Emphasis in original of mailed notices only.)

The reference to Article IX of the 1946 Agreement relates to a provision requiring the assenting Bond holders, in accepting Plan A or Plan B, to assign to the Fiscal Agent any unapplied funds that Mexico may have previously paid to or deposited with the trustees under their respective bond indentures.

53. On information and belief all of the notices so mailed and published were fraudulent, in that they contained intentional misstatements and omissions of facts material to the interests of the holders of non-assenting Prior Lien Bonds.

54. On information and belief all of the members of the association-in-fact knew that, contrary to the implication in the notices, (i) Manufacturers, as trustee, was not a party to the 1946 Agreement and had no obligation for any payments to Mexico or the Fiscal Agent thereunder; (ii) Manufacturers' obligation with respect to the interim interest distributions was to distribute them to the Prior Lien Bond holders in accordance with the terms of Prior Lien Bond indenture; (iii) Mexico's obligations under the 1946 Agreement were in no way dependent upon or affected by Manufacturers' distributions from the trust, and Mexico was in full compliance with those obligations at the respective times of each such distribution; and (iv) in any event Mexico's obligations under the 1946 Agreement were fully discharged, in accordance with its terms, by January 1, 1975.

55. On information and belief each member of the association-in-fact knew and intended that the sums paid to Chase in connection with the interim distributions of interest would be remitted to Mexico. On information and belief such payments to Chase were a sham, conjured up by the members of the association-in-fact to defraud the holders of non-assenting Prior Lien Bonds by effectively treating Mexico as a holder while at the same time disguising the payments as obligations under the 1946 Agreement.

56. To holders of non-assenting Prior Lien Bonds who knew of the artifice no secret was made of the fact that the payments to Chase represented Mexico's share, as a Prior Lien Bonds holder, of each of the interest distributions. Herterich told plaintiff Hubert Park Beck, on more than one occasion, that the payments were being made to Chase as the agent of a holder, not as Fiscal Agent under the 1946 Agreement. As Herterich once stated to said plaintiff, "They have the bonds."

57. Thus on information and belief the members of the association-in-fact, in order to perpetrate the fraud upon the holders of non-assenting Prior Lien Bonds, invented mutually inconsistent theories to support the payment of the lion's share of the interim interest distributions to Mexico; each of the theories was itself untrue, and known to be untrue by each of them.

58. To the non-assenting holders who knew of the 1946 Agreement and understood its provisions the stated position of the association-in-fact was that Manufacturers, as trustee, "wore blinders"; that under the blinders theory Manufacturers was required to treat as a holder of the Bonds anyone in physical possession of them, and was prohibited from looking behind such possession under any circumstances; and that Chase, as Mexico's fiscal agent, was claiming Mexico's share of the interest distributions on the ground that Mexico was thus a holder of the Prior Lien Bonds in its possession.

59. To the other holders of non-assenting Prior Lien Bonds, who did not know of or understand the 1946 Agreement, the position of the association-in-fact was that Manufacturers, as was implicit in the notices mailed and published in connection with the interim interest distributions, was bound by the provisions of that Agreement, and was making the payments to Chase pursuant to those provisions.

60. On information and belief all of the notices mailed by Manufacturers to holders of non-assenting Prior Lien Bonds in connection with the seven interim interest distributions from April 1, 1972 through December 31, 1981 were mailed either by Herterich or by one or more Manufacturers employees acting under Herterich's supervision and control.

61. Plaintiffs submit that each such mailing was a violation, by both Manufacturers and Herterich, of 18 U.S.C. §1341, and thus constituted racketeering activity within the meaning of 18 U.S.C. §1961(1). The repeated violations of 18 U.S.C. §1341, occurring in seven distinct episodes over a period of nearly ten years, constitute, with respect to both Manufacturers and Herterich, a pattern of racketeering activity as defined in 18 U.S.C. §1961(5).

62. On information and belief all of such notices were published in The Wall Street Journal and The New York Times, and were caused to be so published either by Herterich or by one or more Manufacturers employees acting under Herterich's supervision and control.

63. Plaintiffs submit that the publication of each such notice was a violation, by both Manufacturers and Herterich, of 18 U.S.C. §1343, and thus constituted racketeering activity within the meaning of 18 U.S.C. §1961(1). The repeated violations of 18 U.S.C. §1343, occurring in seven distinct episodes over a period of nearly ten years, constitute, with respect to Manufacturers and Herterich, a pattern of racketeering activity as defined in 18 U.S.C. §1961(5).

64. On information and belief:

(i) the defrauding of plaintiffs and other holders of non-assenting Prior Lien Bonds, in connection with the seven interest distributions from April 1, 1972 through December 31, 1981, was made possible by the agreement of all of the members of the association-in-fact to perpetrate such fraud;

(ii) the association-in-fact was formed as the primary vehicle for the effectuation of the fraudulent

scheme; and

(iii) each member of the association-in-fact was involved in the planning and execution of all aspects of the fraudulent scheme, including the mailing and publication of the fraudulent notices.

B. Phase II

65. On information and belief at meetings during the 1970's, and at an accelerated pace beginning in the fall of 1981, the members of the association-in-fact engaged in discussions with Mexican nationals looking toward a sale of the collateral. These meetings took place in both New York and Mexico City.

66. Plaintiffs were not invited to participate in these meetings; indeed, they were not even told about them, or of the plan to sell the collateral. The members of the association-in-fact knew, or should have known, in view of the lengthy history of plaintiffs' interest in the Bonds and Manufacturers' and Kelley's correspondence with plaintiffs' attorneys, that plaintiffs would have participated in the discussions if they had been afforded the opportunity. In participating in these private discussions Manufacturers, as trustee, knowingly breached its duty to plaintiffs by planning the sale with one trust beneficiary (assuming, *arguendo*, that Mexico was a holder of its Bonds) to the exclusion of all others.

67. The justification of the members of the association-in-fact for these private discussions is predicated on the provisions of Article Four, Section 5 of the Prior Lien Bond indenture, which they read as empowering the holders of 75% or more in principal amount of the Prior Lien Bonds to direct the trustee to sell the collateral. On the basis of their position that Mexico held 95.83% of the issued

principal of the Prior Lien Bonds, an anticipated direction of the Mexican nationals to sell the collateral, and their reading of Article Four, Section 5, defendants proceeded with the planning of the sale.

68. Clearly, as on information and belief each defendant knew, a right in bond holders to order a sale, even if it existed, would not carry with it the power to demand the secret participation of the indenture trustee in its planning.

69. Nor, as on information and belief each defendant knew, would such a right in bond holders exculpate Manufacturers as trustee from its obligation to obtain a fair and independent valuation of the collateral for the purpose of the sale.

70. In fact, however, Article Four, Section 5 confers no right to direct a sale. Not even conditioned on the default of the issuer, its provisions are purely administrative, conferring only a right to direct where a sale should take place and the method by which it is conducted. A provision of Article Four, Section 4 does give the holders of 25% of the outstanding principal, on default by the issuer, the right to require the trustee to take, in its discretion, one or more affirmative steps to safeguard the collateral. This provision requires written notice, however, which, according to Herterich and Roberts, Manufacturers never obtained. (A photocopy of Sections 4 and 5 of Article Four of the Prior Lien Bond indenture is annexed as Exhibit B.)

71. On information and belief each defendant knew that Article Four, Section 5 did not confer upon any bond holder a right to direct a sale, but intentionally misread its provisions to confer such a right.

72. On information and belief defendants' intentional misrepresentation of the provisions of Section 5 was occasioned by their desire to distance themselves from the sale of collateral, which they knew would constitute a fraud upon the holders of non-assenting Bonds.

73. On information and belief defendants concocted their sham reading of Section 5 in order to elide the writing requirement of Section 4, which they knew the Mexican nationals would not comply with because of the fraudulent nature of the sale. On information and belief in so misreading Section 5 defendants consciously aided and abetted the fraud perpetrated upon the non-assenting Bond holders.

74. On information and belief the Mexican nationals could not comply with the writing requirement of Section 4 not only because of the fraud upon the non-assenting Bond holders, but also (and primarily) because they were already planning Phase III — the defrauding of the government and people of Mexico of the proceeds of the sale.

75. Manufacturers' position with respect to Section 5 is set forth in a letter on its letterhead, dated October 22, 1982, from William B. Dodge to Edward M. Sills, plaintiffs' then counsel. The letter (Exhibit C annexed hereto), which on information and belief was prepared under the supervision and control of Herterich, was in response to an October 7th letter from Sills to Manufacturers requesting information regarding the sale. In ¶¶ 3 and 4 of his letter Dodge sets forth the provisions of Section 5, and states Manufacturers' position that it was ordered to conduct the sale by "the holders of more than 75% of the outstanding Bonds"

76. On information and belief the mailing of Exhibit C, containing the fraudulent misreading of Section 5, was,

with respect to both Manufacturers and Herterich, a violation of 18 U.S.C. §1341, and thus constituted racketeering activity within the meaning of 18 U.S.C. §1961(1).

77. On information and belief each defendant knew of Exhibit C and was aware of its misinterpretation of the provisions of Section 5, but agreed to and/or acquiesced in its mailing in conjunction with the common scheme of the association-in-fact to defraud the holders of non-assenting Bonds of the proceeds of the sale of collateral.

78. Defendants' attempt to distance themselves from the sale of collateral through the fiction that the sale was directed by Mexico as a holder of Prior Lien Bonds thus failed: no right in a holder to direct a sale is conferred in Article Four, Section 5; and the written notice provision of Section 4, which does confer such a right, was (assuming *arguendo* that Mexico was a Bond holder) not complied with.

79. Thus with respect to the sale of collateral and the secret preparations therefor Manufacturers as trustee was acting completely on its own, in a conscious and willful breach of its fiduciary obligations to plaintiffs and the other non-assenting Bond holders. The damages to plaintiffs would not have occurred but for that breach.

80. On information and belief defendants' intentional misinterpretation of Section 5 did not stop with the bogus conferral of a right in bold holders to direct a sale. Defendants went further, construing that right to permit the directing bond holders to procure their own valuations of the collateral and foist them on the trustee for the purposes of the sale. Thus Manufacturers, without question and with the knowledge of the other defendants, predicated the value of the collateral sold upon valuations procured by the Mexican nationals — valuations that on

information and belief the defendants knew or should have known to reflect only a fraction of the value of the collateral, and that were procured in order to perpetrate the fraud the Mexican nationals were planning.

81. Valuations relating to three items of the collateral set forth in ¶ 21, *supra*, were obtained in preparation for the sale. The first, by Azios and Associates, a Laredo realtor, covered real estate (the "owned land") in Laredo, Robstown, Alice, and Corpus Christi, Texas. The second, by a realtor not known to plaintiffs at the present time, covered real estate in Laredo (the "leased land") which on information and belief was owned by National and leased to Tex-Mex. The third, by Lehman Brothers Kuhn Loeb, Inc. ("LBKL"), involved the determination of the value of Tex-Mex. No value was placed on any other item of collateral, such as the U.S. \$960,000 Corpus Christi, San Diego & Rio Grande Narrow-Gauge Railroad Company 7% bonds due July 1, 1910 (¶ 21 (iii)), or the U.S. \$1,380,000 Tex-Mex 6% bonds due July 1, 1921 (¶ 21(iv)).

82. On information and belief these valuations were procured, not by Manufacturers as trustee, but by the Mexican nationals. Manufacturers used the valuations in setting the upset price for the sale, accepting their assumptions and conclusions on the theory, promulgated by the association-in-fact, that it had no choice — that the "right" to direct the sale conferred in Article Four, Section 5 included the right to procure valuations of the collateral, direct the assumptions upon which they were made, and require the trustee to accept their results.

83. Defendant went so far as to treat the valuations as the actual property of Mexico. When, subsequent to the sale, plaintiffs' attorney asked Roberts, as Manufacturers' counsel, for copies of the valuations, Roberts stated that permission would have to be obtained from Milbank, as

Mexico's counsel. About three weeks later Roberts reported that Shapiro had informed him that Milbank had denied such permission; plaintiffs' counsel would be permitted only to look at the valuations; he would not be permitted to photocopy them, or even to make any notes about them.

84. Plaintiffs' counsel stated to Roberts that plaintiffs, as trust beneficiaries, had an absolute right to copies of the valuations, upon which the upset price for the sale had been set; and that Manufacturers, as trustee, had a clear fiduciary obligation to provide them. Roberts, however, would not relent.

85. Incredulous, but with little choice at that time, plaintiffs' attorney accepted the conditions. He was permitted to spend one and one-half noteless hours in Roberts' office at the Kelley firm, under the constant supervision of Roberts. During this time he was able to examine two of the valuations (Roberts said he did not have, and had never seen, the third). One and one-half years later Milbank furnished plaintiffs' counsel with copies of the valuations — pursuant to an order of Justice Evans in *Beck I*.

86. The valuations, all dated in May, 1982, were made on the assumption (imposed by the Mexican nationals) of the continuance of Tex-Mex as an operational railroad. On information and belief that assumption led to a valuation of the collateral that was far below its fair market value.

(1) The valuation of the owned land

87. The total value arrived at for the owned land was \$2,245,000. Annexed hereto as Exhibit D is a photocopy of the covering letter from Azios and Associates, dated

May 12, 1982, setting forth that value. The letter is addressed not to Manufacturers as trustee, but to Andres Ramos, as President of Tex-Mex. The first paragraph of the letter makes clear that the valuation had been done at Ramos' request.

88. On information and belief each defendant knew that the appraisal of the owned land had been procured by and done under the direction of Ramos, and that Ramos was President of Tex-Mex.

89. On information and belief each defendant also knew that the figure of \$2,245,000 in the valuation is about 20% of the cost of the owned land, which is set forth as \$12,323,000 in Tex-Mex's balance sheet as of December 31, 1981 (Exhibit E at pp. 2 and 6 (Note A)). On information and belief each defendant knew or should have known the owned land to be worth many times its cost. Yet, confronted with an appraised value of about one-fifth of its cost, no defendant raised any question regarding the validity of the appraisal.

(2) The valuation of the leased land

90. On information and belief the leased land, in downtown Laredo, was leased from National by Tex-Mex; while some of it is used for Tex-Mex's right-of-way and related railroad purposes, the greater part of it is not.

91. On information and belief the leased land's greatest value would be realized by ceasing the operations of Tex-Mex and developing the entire tract. Even with Tex-Mex as an operating entity, however, the portion of the land not necessary for operations is extraordinarily valuable.

92. The valuation of the leased land should have been

unacceptable on its face. It does not contain a certification, by any realtor, as to its accuracy. It contains no description of any of the parcels, merely setting forth, for each, its identifying number, its appraised value per square foot, the number of square feet under consideration, and the product of the last two figures, which is set forth as the value of the parcel.

93. The average value assigned to the parcels is about \$1.00 per square foot. On information and belief each defendant knew that this was a small fraction of the value of the parcels. No indication is given in the valuation of the considerations that resulted in the assigned values. Since clear title to the land was to be delivered at the sale, the existing mortgages should not have been a factor. Even after a full deduction for such encumbrances, however, on information and belief the actual values of the parcels would have been vastly greater than the appraised values.

94. There is no recapitulation or summary in the valuation setting forth the total value of the parcels. (The LBKL valuation, discussed below, sets forth \$3,475,000 as such total value.) On information and belief all of the defendants knew that the inherent value of the leased land for non-railroad purposes was vastly greater than the sum of the appraised values of the parcels. On information and belief they also knew that more than half of the leased land was not necessary for railroad operations, and that even if Tex-Mex were not shut down, the value of such unnecessary portion would exceed the principal and accrued interest due on all of the outstanding Bonds. Defendants, however, raised no question as to the validity of the appraisal or its subsequent exclusion by LBKL from Tex-Mex's value. Nor did they cause any value to be allocated to the leased land as an independent item of collateral, even though it was being sold as such

(¶ 21(ii), *supra*).

(3) The LBKL valuation of Tex-Mex

95. On information and belief the LBKL valuation of Tex-Mex, procured by the Mexican nationals, was based primarily upon data provided by Tex-Mex. Annexed hereto as Exhibit F are photocopies of the cover sheet and the first (unnumbered) page of the LBKL valuation. The cover sheet bears the following legend:

Confidential: Prepared solely for the use of the Government of Mexico and its Agencies.

The first (unnumbered) page bears the following legend:

This is a confidential memorandum prepared solely for the use of the Government of Mexico and its Agencies. This memorandum has been prepared by Lehman Brothers Kuhn Loeb Incorporated ("LBKL") primarily from information received from The Texas Mexican Railway Company, and no independent verification of this material has been made by LBKL. LBKL makes no representations or warranties, expressed or implied, as to the accuracy or completeness of this confidential memorandum or any of its contents, and no legal liability is assumed or to be implied with respect thereto.

96. Two things stand out about the legends: that the valuation was prepared for Mexico on the basis of unverified information provided by Tex-Mex with Manufacturers, as trustee, having had nothing to do with it; and the

extraordinary length to which LBKL felt compelled to go to disclaim any responsibility for the accuracy of the valuation. On information and belief each of the defendants was fully aware of both legends.

97. In evaluating Tex-Mex LBKL compared it to some other railroads and, after discussing their similarities and differences, concluded that Tex-Mex was worth approximately from six to seven times its anticipated annual net earnings, or from \$19,800,000 to \$23,100,000.

98. To this figure LBKL added (i) \$7,200,000, representing the portion of Tex-Mex's cash deemed not necessary for operations, and (ii) \$2,200,000, representing the approximate appraised value of the owned land. (Erroneously concluding, on the basis of information furnished by Tex-Mex, that all of the leased land was necessary for railroad operations and did not add to Tex-Mex's value, LBKL excluded it entirely from its valuation of Tex-Mex.) The addition of the three figures yielded a total value of from \$29,200,000 to \$32,500,000 for Tex-Mex as an operating entity.

99. Manufacturers, taking the approximate average of these figures, set \$31,000,000 as the upset price for the entire collateral at the sale. In so doing, no account was taken of the following:

(i) On information and belief the leased land, if committed to its most profitable use, would alone be worth more than the upset price;

(ii) On information and belief the portion of the leased land not necessary for operation of the railroad would, even if Tex-Mex were not shut down, be worth enough to pay in full the principal accrued interest on all outstanding Prior Lien Bonds and Consolidated

Mortgage Bonds.

(iii) On information and belief the value of the owned land, which cost \$12,323,000 and was appraised at \$2,245,000, also exceeds the total principal and accrued interest due on all outstanding Bonds.

(iv) Tex-Mex's balance sheet, as of December 31, 1981, showed accounts receivable of \$6,300,000 (Exhibit E, p. 2). No upward adjustment in the value of Tex-Mex was made for this, despite LBKL's determination that the railroad had more working capital than it needed.

(v) Tex-Mex's balance sheet, as of December 31, 1981, sets forth current liabilities of \$2,340,000 in principal and \$6,486,000 in accrued interest due on bonds in default (*Id.* at p. 3). As Note B to the schedule makes clear, (*Id.* at pp. 6 and 7), the bonds are the very ones being sold as part of the collateral: the \$960,000 Corpus Christi, San Diego & Rio Grande Narrow Gauge Railroad Company 7% bonds due July 1, 1910 (¶ 21 (iii)), and the \$1,380,000 Tex-Mex 6% Gold Bonds due July 1, 1921 (¶ 21(iv)). According to the last paragraph of Note B, Tex-Mex was paying in full the currently accruing annual interest of \$150,000 on the bonds. And at the completion of the sale the purchaser of the collateral would be able to write himself a check from land-, cash-, and receivable-rich Tex-Mex, in the sum of \$8,826,000 in payment of the principal and accrued interest on the bonds. Yet no value at all was placed upon the bonds for the purpose of the sale.

(vi) Tex-Mex was, at the time of the LBKL valuation, in the process of developing an industrial park containing twenty-four parcels. The company had, according to the valuation, already sold one parcel, received 20% down payments on nineteen more, and was close to obtaining commitments on the last four. On information

and belief LBKL wrongly excluded the value of the industrial park from its valuation of Tex-Mex. No upward adjustment in the value of Tex-Mex was made to reflect this investment.

(vii) The Purchase Agreement, which on information and belief was drafted for Manufacturers by Kelley under Roberts' supervision, does not call for the apportionment of Tex-Mex's 1982 net income. Thus, despite the fact that the closing took place on November 29th, the entire net income for calendar year 1982 passed to the purchaser of the collateral. Tex-Mex had net income of \$7,924,000 before taxes during the previous year—calendar year 1981 (*Id.*, at p. 4).

(viii) On information and belief no value was attributed to the interest in the International Railroad Bridge being sold as part of the collateral (¶ 21 (v)).

100. On information and belief each defendant was, prior to the sale, fully aware of all of the facts set forth in ¶ 99, *supra*.

101. On information and belief Shapiro, during the first 4-1/2 months of 1982, engaged in interstate telephone conversations regarding the valuation of the owned land, the valuation of the leased land, the LBKL valuation of Tex-Mex, and the values of other items of collateral. On information and belief such conversations were held with one or more of J. M. Azios, Andres Ramos, perhaps other officers of Tex-Mex, and other Mexican nationals.

102. On information and belief during such telephone conversations Shapiro counselled such persons as to the contents of such valuations and their use in the sale of the collateral. On information and belief at the respective

times of such conversations Shapiro knew or had reason to believe that, for reasons set forth in ¶ 99, *supra*, and perhaps others, each of such valuations would or did substantially underestimate the value of the property under consideration. On information and belief he also knew at such times that certain items of collateral with substantial value, such as the bonds referred to in ¶ 99 (v), *supra*, would not be professionally appraised at all for the sale. On information and belief he also knew at such times that Manufacturers intended to predicate the upset price for the sale on the valuations thus obtained, and that the net proceeds of the sale would, as a likely result, be considerably less than the fair market value of the collateral.

103. On information and belief each of such telephone conversations was, with respect to both Milbank and Shapiro, a violation of 18 U.S.C. §1343, and thus constituted racketeering activity within the meaning of 18 U.S.C. §1961(1). On information and belief the aggregate of such conversations constituted, with respect to both Milbank and Shapiro, a pattern of racketeering activity within the meaning of 18 U.S.C. §1961(5).

104. While the appraisals were being made, the meetings between defendants and the Mexican nationals continued. At a January 1982 meeting in New York an officer of Banco de Mexico told Herterich and Roberts to proceed with the sale; this instruction was subsequently rescinded. At an April 1982 meeting in Mexico City attended by Herterich and Roberts a provisional go-ahead was given, subject to confirmation.

105. In due course a "direction" was given to defendant to schedule the sale. On information and belief, and according to Roberts, an officer of Banco de Mexico (where Mexico's Prior Lien Bonds were held) telephoned the direction from Mexico City to Shapiro, as Mexico's

counsel; Shapiro relayed it to Roberts as counsel to Manufacturers. Shapiro's participation in this international telephone conversation, which precipitated a sale that on information and belief he and Milbank knew to constitute a fraud upon the holders of non-assenting Bonds, was, as to both Milbank and Shapiro, a violation of 18 U.S.C. §1343, and thus constituted racketeering activity within the meaning of 18 U.S.C. §1961(1).

106. On information and belief no attempt was ever made by any defendant to confirm the authority of the officer who gave the direction, despite the fact that each of them knew he was not an official of the Mexican government. On information and belief, and according to Herterich and Roberts, no writing embodying the order was ever requested or received by any defendant. Despite requests therefor, Roberts refused to give the name of the officer to plaintiffs' counsel.

107. The sale was scheduled to take place in Laredo, on November 2, 1982.

108. On or about August 10, 1982 a Notice of the sale of collateral was published in both The Wall Street Journal and The New York Times. (A photocopy of the Notice of Sale is annexed hereto as Exhibit G.)

109. On information and belief the Notice of Sale was fraudulent, for the following reasons, all of which were known to each defendant:

(i) The Notice states that the sale is to be conducted by Manufacturers as trustee under the Prior Lien Bond indenture. On information and belief all of the defendants knew that the collateral being sold secured the Consolidated Mortgage Bonds as well, and that the true value of the collateral exceeded the principal and accrued

interest owed on the outstanding Bonds of both series. The Notice, in referring only to the Prior Lien Bonds, failed to inform the Consolidated Mortgage Bond holders of their interest in the sale.

(ii) The \$31,000,000 upset price set forth in the Notice further implied that the Consolidated Mortgage Bond holders had no interest in the sale, since that sum was far less than the principal and accrued interest owed on the more senior Prior Lien Bonds. As is set forth above, the \$31,000,000 figure was based upon the fraudulently low value set on the collateral by defendants.

(iii) The sum of U.S. \$81,704,625 set forth in the Notice as due on the Prior Lien Bonds was, on information and belief, less than half the principal and accrued income actually owing on them. According to Herterich and Roberts the interest portion of the amount due was computed on the basis of simple interest. The indentures for both series of Bonds require compounding, however. Indeed, on information and belief Manufacturers' predecessor trustee, Central Hanover Bank and Trust Company, actually compounded interest for the purpose of determining the amount owed on the Prior Lien Bonds in a 1938 lawsuit against Ferrocarriles. On information and belief each defendant knew the \$81,704,625 figure set forth in the Notice to be a fraction of the amount due on the Prior Lien Bonds.

(iv) The Notice fails to disclose that the \$31,000,000 upset price was based upon valuations procured not by Manufacturers as trustee, but by the Mexican nationals, whose interests were antithetical to those of the holders of the non-assenting Bonds.

110. On information and belief the publications of the Notice of Sale in The Wall Street Journal and The New

York Times were done on behalf of Manufacturers under the supervision and control of Herterich. Each such publication was, with respect to both Manufacturers and Herterich, a violation of 18 U.S.C. §1343, and therefore constituted racketeering activity within the meaning of 18 U.S.C. §1961(1); both publications constituted, with respect to those defendants, a pattern of racketeering activity within the meaning of 18 U.S.C. §1961(5).

111. On information and belief on or about October 5, 1982 Roberts, on Kelley letterhead, wrote to all persons listed on Manufacturers' books as holders of Prior Lien Bonds, informing them of the sale. (A photocopy of Roberts' letter to plaintiff Hubert Park Beck is annexed hereto as Exhibit H.) On information and belief each such letter included a copy of the fraudulent Notice of Sale. The mailing of each of such letters was, with respect to both Kelley and Roberts, a violation of 18 U.S.C. §1341, and therefore constituted racketeering activity within the meaning of 18 U.S.C. §1961(1).

112. On information and belief the publications and mailings of the Notice of Sale were done pursuant to the agreement of each of the defendants as a member of the association-in-fact, in a conscious attempt to defraud the holders of non-assenting Bonds of their rightful share of the true value of the collateral.

113. On or about October 18, 1982 Herterich and William B. Dodge, his assistant, traveled to Mexico City and, at Banco de Mexico, counted Mexico's Prior Lien Bonds, verifying that \$22,040,500 in principal amount was on hand.

114. The sale took place as scheduled on November 2nd. Present were, among others, Herterich, who conducted the sale on behalf of Manufacturers; Roberts, as

counsel to Manufacturers; and Shapiro, as counsel to Mexico.

115. The sale began and concluded with one bid — by a corporation called Mexrail, Inc., for the upset price of \$31,000,000. There being no other bidders, Mexrail's bid was accepted by Herterich and the auction ended.

116. Manufacturers allocated \$1,292,700, or 4.17% of the proceeds of the sale, to the holders of non-assenting Prior Lien Bonds; this represented the \$959,500 in face amount (or 4.17%, of the original \$23,000,000 issue) that had not come into Mexico's possession over the years, either by tender under the 1946 Agreement or through open-market purchases.

117. The balance of \$29,707,300 was paid, not in money, but by a purported tender by Mexrail and acceptance by Manufacturers of Mexico's \$22,040,500 in Prior Lien Bonds. (Article Four, Section 13 of the Prior Lien Bond indenture permits a holder of those bonds to tender them at a sale of the collateral and receive a credit against the sale price for his ratable share of the sale proceeds, based upon the principal and accrued interest due on his bonds. This will be more fully discussed below, in connection with Phase III.)

118. On information and belief on or about December 20, 1982 Manufacturers mailed a notice to all of the holders of Prior Lien Bonds on its books that, from the proceeds of the sale, it would distribute, on account of accrued and unpaid interest, \$1,355 per \$1,000 Prior Lien Bond. (A photocopy of the notice received by plaintiff Hubert Park Beck is annexed hereto as Exhibit I.)

119. On information and belief Manufacturers also caused the notice so mailed to be published in The Wall

Street Journal and The New York Times on or about December 21, 1982.

120. The notice so mailed and published was in the same form and contained substantially the same language as the notices mailed and published in connection with the seven interim distributions of interest in Phase I (see Exhibit A hereto). In particular, the notice contained the statement, set forth in ¶ 52, *supra*, to the effect that the portion of the distribution allocable to the assenting Prior Lien Bonds was being made not to "the holders," but to Chase, as Fiscal Agent under the 1946 Agreement.

121. On information and belief the notice was fraudulent for the reasons set forth in ¶ 54, *supra*, and for the following reasons:

(i) The notice failed to disclose that the \$31,000,000 sale price was based upon fraudulently understated values of the collateral.

(ii) The notice stated that the amount of the distribution on the assenting bonds was being made to Chase as Fiscal Agent under the 1946 Agreement. As each defendant knew, there was in fact to be no such distribution. Only \$1,292,700 in cash had been realized on the sale, and this sum had been set aside by Manufacturers for the portion of the distribution allocable to the non-assenting bonds. The balance of \$29,707,300 had been paid, not in money, but by Mexrail's purported tender of the assenting bonds themselves. There was simply no money to pay to Chase, and on information and belief no such payment was ever made.

(iii) The notice failed to disclose that Manufacturers, as trustee, knew that Mexrail's purported tender of the bonds had been shot through with fraud,

and accordingly should not have treated Mexrail as a holder even if the bonds had been valid and outstanding.

122. On information and belief the mailings and publications of the notice were done on behalf of Manufacturers under the supervision and control of Herterich. Each such mailing was, with respect to both Manufacturers and Herterich, a violation of 18 U.S.C. §1341, and therefore constituted racketeering activity within the meaning of 18 U.S.C. §1961(1). Each such publication was, with respect to both Manufacturers and Herterich, a violation of 18 U.S.C. §1343, and therefore also constituted racketeering activity within the meaning of 18 U.S.C. §1961(1). The aggregate of such mailings and publications constituted, with respect to those defendants, a pattern of racketeering activity within the meaning of 18 U.S.C. §1961(5).

123. On information and belief each of the defendants, as a member of the association-in-fact, knew that the notice was fraudulent, for the reasons set forth in ¶ 121, *supra*. On information and belief the mailings and publications of the notice were done pursuant to the agreement of each of the defendants as a member of the association-in-fact, in a conscious attempt to defraud the holders of non-assenting Bonds of their rightful share of the true value of the collateral.

124. On information and belief Manufacturers, in connection with the distribution of the proceeds of the sale of collateral, mailed a Letter of Transmittal to each holder of non-assenting Prior Lien Bonds on its books. This letter, when completed and executed by a holder and returned to Manufacturers, would qualify such holder for his share of the distribution. (A copy of the Letter of Transmittal mailed to plaintiff Hubert Park Beck is annexed hereto as Exhibit J.)

125. On information and belief, for the reasons set forth in ¶ 121, *supra*, the Letter of Transmittal was fraudulent.

126. On information and belief the mailings of the Letter of Transmittal were done on behalf of Manufacturers under the supervision and control of Herterich. Each such mailing was, with respect to both Manufacturers and Herterich, a violation of 18 U.S.C. §1341, and therefore constituted racketeering activity within the meaning of 18 U.S.C. §1961(1).

127. On information and belief each of the defendants, as a member of the association-in-fact, knew that the Letter of Transmittal was fraudulent, for the reasons set forth in ¶ 121, *supra*. On information and belief the mailings of the Letter of Transmittal were done pursuant to the agreement of each of the defendants as a member of the association-in-fact, in a conscious attempt to defraud the holders of non-assenting Bonds of their rightful share of the true value of the collateral.

C. Phase III

128. On information and belief during the spring of 1982, and perhaps before, defendants were informed by the Mexican Nationals that payment for the collateral sold would likely be made, in substantial part, with the Prior Lien Bonds in Mexico's possession. (As is set forth in ¶ 117, *supra*, Article Four, Section 13 of the Prior Lien Bond indenture permits a holder of those bonds to tender them at a sale of the collateral and receive a credit against the sale price for his ratable share of the sale proceeds, based upon principal and accrued interest due on his bonds. Article Four, Section 13 of the Consolidated Mortgage Bond indenture contains an identical provision.)

129. Defendants should not have been surprised by this. Given their position that Mexico was a holder of 95.83% of the Prior Lien Bonds, and their calculation that \$81,704,625 was owing on those bonds, they knew that Mexico could appear at the sale, bid as high as \$81,704,625 for the collateral, and receive a credit of $(\$81,704,625) \times (0.9583)$, or \$78,297,542, against the sale price. Thus Mexico would have had to pay only \$3,407,083 in cash for its \$81,704,625 bid, and receive in return \$31,000,000 worth of property (even at defendants' fraudulently understated value of the collateral). Mexico could begin by bidding the upset price of \$31,000,000, for which it would receive a credit of $(\$31,000,000) \times (0.9583)$, or \$29,707,300, leaving only \$1,292,700 to be paid in cash.

130. Indeed Mexico could cheaply have bid far more than \$81,704,625 for, as each defendant knew, it could have tendered its Consolidated Mortgage Bonds and received a credit of 95.50% against any portion of the purchase price in excess of that amount.

131. Actually, as on information and belief each defendant knew, the cash portion to be paid by Mexico would in reality have been considerably less than the amounts set forth above, for Mexico was a substantial creditor of Tex-Mex. As of December 31, 1981 Tex-Mex owed Mexico \$1,061,000. (This figure is carried as a current liability on Tex-Mex's balance sheet as of December 31, 1981, Exhibit E at p. 3.) On information and belief the debt had grown, and was considerably higher, at the time of the sale.

132. But taking the December 31, 1981 figure of \$1,061,000 as the amount owed at the time of the sale, each defendant knew that Mexico could bid the upset price of \$31,000,00 for a cash commitment of only \$231,700 (\$1,292,700 less \$1,061,000); and that it could bid as high as \$81,704,625 with a cash outlay of only \$2,346,083

(\$3,407,083 less \$1,061,000). Mexico could obtain a credit of \$1,061,000 against the cash portion of the sale price by tendering an instrument of forgiveness to Tex-Mex in that amount; Manufacturers, which as trustee held 24,991 of Tex-Mex's issued and outstanding 25,000 common shares, could then have written a check from cash-rich Tex-Mex to itself as trustee, to be distributed to the non-assenting holders.

133. On information and belief, however, during the summer of 1982 defendants learned that the Prior Lien Bonds in Mexico's possession would be tendered, not by Mexico, but by Mexrail. As on information and belief each defendant knew, Mexrail was a newly-formed Delaware corporation, wholly owned by Transportacion Maritima Mexicana, S.A. ("TMM"), which was in turn owned approximately 70% by Mexican nationals and approximately 30% by the government of Mexico.

134. On information and belief Shapiro and Roberts, during the summer and fall of 1982, engaged in interstate and international telephone conversations regarding the sale. On information and belief such conversations were held with one or more of Andres Ramos, President of Tex-Mex; Roberto Dieguez Armas, Mexico's Director of the Public Debt and a director of Tex-Mex; one or more other officers of Tex-Mex; and one or more officers of Banco de Mexico.

135. On information and belief during these conversations Shapiro and Roberts were informed that Mexrail did not wish to physically tender the bonds, but wished instead to tender one or more assignments of the bonds in payment of 95.83% of the sale price. On information and belief Shapiro and Roberts were further informed that neither Mexrail nor anyone else would enter into any written agreement with Mexico that would set forth the

receipt of any monetary consideration by Mexico for the assignment of its bonds.

136. On information and belief each defendant knew, or should have strongly suspected at this point, that the Mexican nationals were engaged in a criminal conspiracy to defraud their own government and fellow countrymen. From the refusal of the Mexican nationals to provide Manufacturers with a written direction to sell the collateral (¶ 73, *supra*) to their refusal to provide a written agreement setting forth Mexico's consideration for the assignment of its bonds, the impending transaction appeared to be rife with fraud.

137. Nevertheless, on information and belief during his foregoing telephone conversations Roberts discussed the contents of the assignments and transmitted Manufacturers' agreement to accept them, without any underlying written agreement setting forth the amount of consideration received by Mexico therefor, in payment of 95.83% of the sale price.

138. On information and belief each of such telephone conversations was, with respect to both Kelley and Roberts, a violation of 18 U.S.C. §1343, and therefore constituted racketeering activity within the meaning of 18 U.S.C. §1961(1). The aggregate of those conversations constituted a pattern of racketeering activity within the meaning of 18 U.S.C. §1961(5).

139. Milbank and Shapiro, as counsel to the government of Mexico, were under a particularly strong professional obligation at this point. They knew that Mexico could appear at the sale and, by tendering its Prior Lien Bonds and an instrument of forgiveness, bid the \$31,000,000 upset price for a cash outlay of only \$231,700, and bid \$81,704,625 for a cash outlay of only \$2,346,083.

They were thus under a clear duty to counsel their client to appear at the auction, and to outbid everyone else in the room for the collateral.

140. Milbank and Shapiro should, at the very least, have taken steps to ensure that Mexico was compensated for its bonds.

141. On information and belief Milbank and Shapiro did neither. On information and belief during Shapiro's telephone conversations set forth in ¶¶ 134 and 135, *supra*, they actually aided and abetted the defrauding of their client by counseling the Mexican nationals with respect to the drafting and execution of the assignments. On information and belief among the matters discussed during those conversations were the contents of the assignments and the identities of the persons who would execute and witness them.

142. On information and belief each of such telephone conversations was, with respect to both Milbank and Shapiro, a violation of 18 U.S.C. §1343, and constituted racketeering activity within the meaning of 18 U.S.C. §1961(1). The aggregate of those conversations constituted, with respect to those defendants, a pattern of racketeering activity within the meaning of 18 U.S.C. §1961(5).

143. Manufacturers, as trustee, was under a duty as well — to the holders of non-assenting Bonds such as plaintiffs. If Mexico had been apprised of its rights it would surely have been a bidder at the sale, and would have continued to bid in the face of escalating opposing bids. Under these circumstances the sale price, and thus the value of the portion of the proceeds allocable to the non-assenting Bonds, would have been substantially increased.

144. On information and belief Manufacturers did nothing to inform the Mexican government of its rights, however. As Roberts told plaintiffs' counsel "We [that is, all of the defendants] didn't look behind what we were told about the Mexican side of the sale."

145. As is set forth above, the sale of collateral was held in Laredo on November, 2, 1982. Mexrail, the only bidder, was awarded the collateral for the upset price of \$31,000,000.

146. In payment of the purchase price Mexrail tendered a check for \$1,292,700, a certification, and two assignments. The \$1,292,700, or 4.17% of the sale price, was allocated to the holders of non-assenting Prior Lien Bonds.

147. The certification, on the letterhead of Banco de Mexico, sets forth that that bank is holding, on behalf of Mexico, \$22,040,000 in principal amount of Prior Lien Bonds. It is signed by Emilio Gutierrez Moller and Hector Reyes Retana, two officers of the bank. (A photocopy of the certification is annexed hereto as Exhibit K.)

148. The assignments were both dated November 2nd and set forth the transfer of \$22,040,500 in principal amount of Prior Lien Bonds. The first assignment (Exhibit L annexed hereto) was from Mexico to TMM, the second (Exhibit M) was from TMM to Mexrail.

149. The assignment from Mexico to TMM is a one-page document bearing both a printed letterhead and a typed "letterhead." The assignment recites that "for value received" Mexico was assigning all of its Prior Lien Bonds to TMM. It is signed by C. P. Roberto Dieguez Armas, whose title is set forth as Director of the Public Debt (and who also apparently witnessed the execution

of the assignment from TMM to Mexrail). The assignment is not notarized, although notarization is an implicit requirement of Article Six, Section 2 of the Prior Lien Bond indenture.

150. On information and belief: no questions were asked by any defendant as to how TMM had obtained its assignment, or whether any consideration had been paid for it; no inquiry was made as to why, if TMM had the \$29,707,300 balance of the sale price, it did not pay it directly, instead of first buying the bonds from Mexico and then tendering them to Manufacturers; no question was raised regarding the absence of a written agreement between TMM and Mexico setting forth the monetary consideration for the assignment; no question was asked regarding the authority of Mr. Dieguez Armas to assign the bonds for Mexico, despite the deficiencies of the assignment itself.

151. On information and belief Mexico received no consideration at all for its assignment to TMM.

152. Mr. Dieguez Armas was, as on information and belief all of the defendants knew, a director of Tex-Mex at the time, with a fiduciary responsibility to free that corporation from the constraint of the trust. Yet, despite his clear conflict of interest, not a question was raised concerning the propriety of his having executed the assignment to TMM on behalf of Mexico, or of his witnessing the subsequent assignment to Mexrail.

153. On information and belief, and according to Roberts, the assignments were drafted under the supervision of Milbank and Shapiro, and were executed in Laredo under Shapiro's supervision on the morning of November 2, 1982, shortly before the sale.

154. On information and belief, and according to Roberts, the certification and assignments were hand-carried to the sale by Shapiro moments before the opening of the bidding.

155. On November 3, 1982, Edward M. Sills, then counsel to plaintiffs, telephoned Roberts. Roberts informed Sills that the sale had taken place on the previous day, that Mexrail had purchased the property for \$31,000,000, and that Mexico's Prior Lien Bonds would likely be used to defray a major portion of the purchase price.

156. On information and belief Roberts also stated to Sills that the sale was subject to the Hart-Scott-Rodino Antitrust Improvements Act of 1976, 15 U.S.C. §1311, which provides for a waiting period of at least thirty days between the formation of a contract of sale and its closing; Roberts stated that Manufacturers, as trustee, intended to procure a waiver of that requirement.

157. Shortly thereafter plaintiff Hubert Park Beck telephoned the Federal office with jurisdiction over the enforcement of the statute, recited some of the facts surrounding the sale, and requested that no waiver of the statute's provisions be granted. He was told that none would be; on information and belief none ever was.

158. Nevertheless defendants proceeded with the closing on November 29, 1982. On information and belief they did so in the full knowledge that they were in violation of Hart-Scott-Rodino, but could not delay the closing because of pressing political considerations of the Mexican nationals: the closing had to occur prior to December 1st, when the incumbent Mexican administration would come to a close, and a new President, Miguel de la Madrid, would be sworn in.

159. On information and belief present at the closing were, among others, Herterich, Shapiro, Roberts, an associate in each of Milbank and Kelley, and a senior official in the Foreign Department of Banco de Mexico.

160. On information and belief the closing involved further irregularities. Burlingham Underwood & Lord, counsel to Mexrail, delivered its legal opinion to the effect that all necessary governmental consents or approvals for the transfer of Tex-Mex had been obtained by Mexrail. Such an opinion is required under §§ 10 and 11(e) of the Purchase Agreement, which on information and belief was drafted for Manufacturers by Kelley under the supervision and control of Roberts.

161. The opinion of the Burlingham firm was expressly restricted to the United States, however; despite the fact that Tex-Mex had substantial operations in Mexico no legal opinion was offered or requested relating to contents or approvals required by the government of Mexico or any its agencies or subdivisions.

162. On information and belief the omission of an opinion regarding Mexican consents or approvals was a conscious decision taken and concurred in by each of the defendants. Such an opinion would necessarily have had to be given by a Mexican law firm, and such consents or approvals by one or more agencies of the Mexican government. On information and belief the Mexican nationals, who were in the process of defrauding their government and fellow citizens, were committed to maintaining a veil of secrecy over the transaction, and had ruled out the procurement of any legal opinion that might have required any participation of the Mexican government in its consummation. On information and belief defendants, in order to aid and abet the fraud, failed to require such an opinion.

163. At the closing Mexrail was not required by Manufacturers, as trustee, to physically tender the Prior Lien Bonds that had purportedly been assigned by Mexico. Indeed on information and belief, despite the presence of an officer of Banco de Mexico, Manufacturers did not even receive a certification, in the form of Exhibit K, to the effect that Exhibit K had been superseded, the bonds had been cancelled, and the cancelled bonds were now being held by Banco de Mexico for Manufacturers. Thus, after the closing, Banco de Mexico was left with "live" bonds that Manufacturers had, for over forty years, recognized as valid, outstanding, and owned by Mexico.

164. On information and belief neither the tender of the bonds nor such superseding certification was required because each defendant knew that neither would or could be given: that the transaction involved criminal fraud on the part of the Mexican nationals, and none of them would involve himself in removing the bonds from Banco de Mexico or certifying that they had been cancelled and were now being held there for Manufacturers.

165. On information and belief, by their participation and acquiescence in the events constituting Phase III, defendants caused a vast fortune that Manufacturers would otherwise have distributed to Mexico to pass to Mexrail, a corporation substantially owned and fully controlled by Mexican nationals.

166. As a result of defendants' actions plaintiffs have suffered injury to their property within the meaning of 18 U.S.C. §1964(c). Had the Mexican government not been defrauded, but rather been informed of its rights with regard to the sale, it would surely have appeared and outbid Mexrail or any other bidder for the collateral. Under these circumstances the sale price would have

exceeded the \$31,000,000 paid by Mexrail, and the portion of the sale proceeds allocated to plaintiffs and the other holders of non-assenting Prior Lien Bonds would have been substantially in excess of the \$1,270,000 actually allocated by Manufacturers.

COUNT ONE
(Against all defendants)

167. Plaintiffs repeat and allege the allegations of paragraphs 1 through 166 hereof.

168. Each of the defendants was a member of the association-in-fact set forth in ¶¶ 41 and 42, *supra*, during the respective periods set forth therein.

169. The association-in-fact was an enterprise within the meaning of 18 U.S.C. §1961(4).

170. That enterprise, which regularly operated in New York, Texas, and Mexico, was engaged in interstate and foreign commerce, and was involved in activities which affected interstate and foreign commerce.

171. Each of the defendants, during his or its membership in that enterprise, and in the course of his or its conduct of and/or participation in the affairs of that enterprise, committed multiple violations of 18 U.S.C. §1341 and/or 18 U.S.C. §1343, as more particularly set forth above.

172. Each such violation constitutes racketeering activity within the meaning of 18 U.S.C. §1961(1).

173. Such multiple episodes of racketeering activity by each defendant constitute, with respect to each defendant, a pattern of racketeering activity within the

meaning of 18 U.S.C. §1961(5).

174. All of the foregoing constitutes, with respect to each defendant, a violation of 18 U.S.C. §1962(c).

175. As a result of defendants' violations of 18 U.S.C. §1962(c) plaintiffs have suffered injury to their property within the meaning of 18 U.S.C. §1964(c).

COUNT TWO
(Against Herterich, Shapiro, and Roberts)

176. Plaintiffs repeat and reallege the allegations of paragraphs 1 through 166 hereof.

177. At the respective times set forth above Herterich was employed by Manufacturers, and Shapiro and Roberts were employed by and/or associated with, respectively, Milbank and Kelley.

178. Each of Manufacturers, Milbank, and Kelley is and has continuously been, throughout the relevant times herein, an enterprise within the meaning of 18 U.S.C. §1961(4).

179. During the relevant times herein each of Manufacturers, Milbank, and Kelley maintained, for the regular conduct of business, offices in several states and/or districts in the United States, and abroad. Accordingly at such times each of them was engaged in interstate and foreign commerce, and was involved in activities which affect interstate and foreign commerce.

180. Each of Herterich, Shapiro, and Roberts, during his employment and/or association with, respectively, Manufacturers, Milbank, and Kelley, and in the course of his conduct of and/or participation in its affairs,

committed multiple violations of 18 U.S.C. §1341 and/or 18 U.S.C. §1343, as more particularly set forth above.

181. Each such violation constitutes racketeering activity within the meaning of 18 U.S.C. §1961(1).

182. Such multiple episodes of racketeering activity by Herterich, Shapiro, and Roberts constitute, with respect to each of them, a pattern of racketeering activity within the meaning of 18 U.S.C. §1961(5).

183. All of the foregoing constitutes, with respect to each of Herterich, Shapiro and Roberts, a violation of 18 U.S.C. §1962(c).

184. As a result of such violations of 18 U.S.C. §1962(c) plaintiffs have suffered injuries to their property within the meaning of 18 U.S.C. §1964(c).

COUNT THREE
(Against Manufacturers, Milbank, and Kelley)

185. Plaintiffs repeat and reallege the allegations of paragraphs 1 through 166 hereof.

186. Each of Manufacturers, Milbank, and Kelley, during the period from October 15, 1970 to the present, committed multiple violations of 18 U.S.C. §1341 and/or 18 U.S.C. §1343, as more particularly set forth above.

187. Each of such violations constitutes racketeering activity within the meaning of 18 U.S.C. §1961(1).

188. Such multiple episodes of racketeering activity by Manufacturers, Milbank, and Kelley constitutes, with respect to each of them, a pattern of racketeering activity within the meaning of 18 U.S.C. §1961(5).

189. Each of Manufacturers, Milbank, and Kelley received, directly and/or indirectly, through trustee's commissions, legal and/or other fees, and/or other means, income from their respective patterns of racketeering activity.

190. Each of Manufacturers, Milbank, and Kelley used and/or invested, directly or indirectly, part of such income, or the proceeds thereof, in

(i) the acquisition of an interest in and/or the establishment and/or operation of the association-in-fact, consisting of all of the defendants, set forth in ¶¶ 41 and 42, *supra*; and/or

(ii) the operation of, respectively, Manufacturers, Milbank, and Kelley.

191. Each of Manufacturers, Milbank, Kelley, and the association-in-fact is an enterprise within the meaning of 18 U.S.C. §1961(4).

192. The association-in-fact, which regularly operated in New York, Texas, and Mexico, was engaged in interstate and foreign commerce, and was involved in activities which affected interstate and foreign commerce.

193. During the relevant times herein each of Manufacturers, Milbank, and Kelley maintained, for the regular conduct of business, offices in several states and/or districts in the United States, and abroad. Accordingly at such times each of them was engaged in interstate and foreign commerce, and was involved in activities which affect interstate and foreign commerce.

194. All of the foregoing constitutes, with respect to

Manufacturers, Milbank, and Kelley, a violation of 18 U.S.C. §1962(a).

195. As a result of such violations of 18 U.S.C. §1962(a), plaintiffs have suffered injuries to their property within the meaning of 18 U.S.C. §1964(c).

COUNT FOUR
(Against all defendants)

196. Plaintiffs repeat and reallege the allegations of paragraphs 1 through 166 hereof.

197. Each of the defendants, during the period from October 15, 1970 to the present, committed multiple violations of 18 U.S.C. §1341 and/or 18 U.S.C. §1343, as more particularly set forth above.

198. Each of such violations constitutes racketeering activity within the meaning of 18 U.S.C. §1961(1).

199. Such multiple episodes of racketeering activity by defendants constitutes, with respect to each of them, a pattern of racketeering activity within the meaning of 18 U.S.C. §1961(5).

200. Each of the defendants, through such pattern of racketeering activity, acquired and/or maintained, directly and/or indirectly, an interest in and/or control of the association-in-fact set forth in ¶¶ 41 and 42, *supra*.

201. That association-in-fact is an enterprise within the meaning of 18 U.S.C. §1961(4).

202. The association-in-fact, which regularly operated in New York, Texas, and Mexico, was engaged in interstate and foreign commerce, and was involved in

activities which affected interstate and foreign commerce.

203. All of the foregoing constitutes, with respect to all of the defendants, a violation of 18 U.S.C. §1962(b).

204. As a result of such violations of 18 U.S.C. §1962(b), plaintiffs have suffered injuries to their property within the meaning of 18 U.S.C. §1964(c).

COUNT FIVE
(Against Herterich, Shapiro, and Roberts)

205. Plaintiffs repeat and reallege the allegations of paragraphs 1 through 166 hereof.

206. Each of Herterich, Shapiro, and Roberts, during the period from October 15, 1970 to the present, committed multiple violations of 18 U.S.C. §1341 and/or 18 U.S.C. §1343, as more particularly set forth above.

207. Each of such violations constitutes racketeering activity within the meaning of 18 U.S.C. §1961(1).

208. Such multiple episodes of racketeering activity by Herterich, Shapiro, and Roberts constitutes, with respect to each of them, a pattern of racketeering activity within the meaning of 18 U.S.C. §1961(5).

209. Herterich, Shapiro, and Roberts, through such pattern of racketeering activity, respectively maintained, directly and/or indirectly, an interest in and/or control of, Manufacturers, Milbank, and Kelley.

210. Each of Manufacturers, Milbank, and Kelley is an enterprise within the meaning of 18 U.S.C. §1961(4).

211. During the relevant times herein, each of Manufacturers, Milbank, and Kelley has maintained, for the regular conduct of business, offices in several states and/or districts in the United States, and abroad. Accordingly, each of them is engaged in interstate and foreign commerce, and is involved in activities which affect interstate and foreign commerce.

212. All of the foregoing constitutes, with respect to Herterich, Shapiro, and Roberts, a violation of 18 U.S.C. §1962(b).

213. As a result of such violations of 18 U.S.C. §1962(b), plaintiffs have suffered injuries to their property within the meaning of 18 U.S.C. §1964(c).

COUNT SIX
(Against all defendants)

214. Plaintiffs repeat and reallege the allegations of paragraphs 1 through 166 and 168 through 174 hereof.

215. As is set forth above, each of the defendants willfully aided and abetted the defrauding of non-assenting Bondholders in Phases I and II, and the defrauding of the government and people of Mexico in Phase III.

216. Defendants (individually and collectively) aided and abetted such fraud through the agreement of each to participate in its planning and execution, and through their acts and omissions adverted to above in connection with the carrying out of the fraudulent scheme.

217. In the course of so aiding, abetting, and participating in such fraud each of the defendants consciously and willfully conspired, with all of the other defendants, to commit the violations of 18 U.S.C. §1962(c) contained

in Count One hereof.

218. Each such conspiracy constitutes, with respect to each defendant, a violation of 18 U.S.C. §1962(d).

219. As a result of such violations of 18 U.S.C. §1962(d), plaintiffs have suffered injuries to their property within the meaning of 18 U.S.C. §1964(c).

COUNT SEVEN
(Against all defendants)

220. Plaintiffs repeat and reallege the allegations of paragraphs 1 through 166, 177 through 183, 215, and 216 hereof.

221. In the course of so aiding, abetting, and participating in such fraud each of the defendants consciously and willfully conspired, with all of the other defendants, to commit the violations of 18 U.S.C. §1962(c) contained in Count Two hereof.

222. Plaintiffs repeat and reallege the allegations of paragraphs 218 and 219 hereof.

COUNT EIGHT
(Against all defendants)

223. Plaintiffs repeat and reallege the allegations of paragraphs 1 through 166, 186 through 194, 215, and 216 hereof.

224. In the course of so aiding, abetting, and participating in such fraud each of the defendants consciously and willfully conspired, with all of the other defendants, to commit the violations of 18 U.S.C. §1962(a) contained in Count Three hereof.

225. Plaintiffs repeat and reallege the allegations of paragraphs 218 and 219 hereof.

COUNT NINE
(Against all defendants)

226. Plaintiffs repeat and reallege the allegations of paragraphs 1 through 166, 197 through 203, 215, and 216 hereof.

227. In the course of so aiding, abetting, and participating in such fraud each of the defendants consciously and willfully conspired, with all of the other defendants, to commit the violations of 18 U.S.C. §1962(b) contained in Count Four hereof.

228. Plaintiffs repeat and reallege the allegations of paragraphs 218 and 219 hereof.

COUNT TEN
(Against all defendants)

229. Plaintiffs repeat and reallege the allegations of paragraphs 1 through 166, 206 through 212, 215, and 216 hereof.

230. In the course of so aiding, abetting, and participating in such fraud each of the defendants consciously and willfully conspired, with all of the other defendants, to commit the violations of 18 U.S.C. §1962(b) contained in Count Five hereof.

231. Plaintiffs repeat and reallege the allegations of paragraphs 218 and 219 hereof.

WHEREFORE, plaintiffs demand damages against the defendants as follows:

- (i) On each of the foregoing ten counts, the sum of \$4,000,000, representing the loss in principal and accrued interest due on plaintiffs' Bonds, trebled to \$12,000,000 pursuant to 18 U.S.C. §1964(c); and
- (ii) the costs of this action and a reasonable attorney's fee pursuant to said section; and
- (iii) appropriate interest and such other relief as this Court shall deem just and proper.

s /
STUART HECKER
Attorney for Plaintiffs
521 Fifth Avenue
New York, New York 10175
(212) 682-7070

EXHIBIT A: PHOTOCOPY OF NOTICE OF
DISTRIBUTION, DATED DECEMBER 11, 1978

To the Holders of
NATIONAL RAILROAD
COMPANY OF MEXICO

Prior Lien 4 1/2% Gold Bonds
dated March 15, 1902

Notice is hereby given that on and after December 15, 1978, the undersigned, as Trustee under the Prior Lien Mortgage of National Railroad Company of Mexico dated March 15, 1902, will distribute an amount equal to 1% of the principal amount of said Bonds, on account of the interest accrued and unpaid on said Bonds as of December 15, 1978, from funds received on underlying collateral securities.

In respect of Bonds which have been stamped to indicate assent to the Offer of the United States of Mexico made pursuant to Mexico's Agreement with the International Committee of Bankers on Mexico dated February 20, 1946, the amount of such distribution will be paid to The Chase Manhattan Bank, Successor Fiscal Agent of Mexico, in accordance with the Assignments provided for in Article IX of said Agreement; and distribution will not be made to the holders of such assenting Bonds.

Holders of non-assenting Bonds may receive such distribution by presenting their Bonds for notation of such payment thereon at the Corporate Trust office of the undersigned, Four New York Plaza, New York, N.Y. 10015, accompanied by a letter of transmittal in form available upon request at such office and, in the case of foreign holders, accompanied by appropriate ownership certificates (U.S. Treasury Department Form 1001).

Unclaimed funds are also available from the following prior distributions:

| | |
|----------------|--------------------|
| 1% payment | December 14, 1942 |
| 1% payment | September 17, 1945 |
| 4% payment | December 26, 1951 |
| 3-1/2% payment | April 28, 1954 |
| 2% payment | April 30, 1957 |
| 5% payment | April 15, 1965 |
| 5% payment | April 1, 1972 |
| 1-1/2% payment | May 15, 1975 |
| 3-1/2% payment | April 1, 1977 |

Bonds not stamped indicating receipt of these previous payments on account of interest should also be presented with appropriate transmittal letters, available upon request at the abovementioned office of Manufacturers Hanover Trust Company.

MANUFACTURERS HANOVER
TRUST COMPANY
as Trustee as aforesaid
By: T. C. Crane
Vice President

Dated: December 11, 1978
New York, N.Y.

EXHIBIT B: SECTIONS 4 & 5, ARTICLE FOUR,
PRIOR LIEN BOND INDENTURE

SECTION 4. In case (1) default shall be made in the payment of any interest on any prior lien bond, or in the performance of any of the covenants of the Railroad Company contained in Section 5 of Article Two hereof, and any such default shall have continued for a period of six months; or in case (2) default shall be made in the due and punctual payment of the principal of any prior lien bond; or in case (3) default shall be made in the due observance and performance of any other covenant or condition herein required to be kept or performed by the Railroad Company, and any such last mentioned default shall have continued for a period of six months after written notice thereof to the Railroad Company from the Trustee, whose duty it shall be to give such notice at the request, in writing, of the holders of at least five (5) per cent. in amount of the prior lien bonds at the time outstanding, then, and in each and every such case of default, provided, however, in respect of each of the two cases so indicated, that such default shall have continued for six (6) months, as above provided, the Trustee, with or without entry, personally or by attorney, in its discretion (a) may sell to the highest and best bidder, all and singular the mortgaged property and premises, rights, franchises and interests, and appurtenances, and other real and personal property of every kind, and all right, title and interest, claim and demand therein, and right of redemption thereof, in one lot and as an entirety, unless a sale in parcels shall be required under the provisions of Section 6 of this Article, in which case such sale may be made in parcels as in said Section provided; such sale or sales shall be made at public auction at such place in the City of New York, in the State of New York, or at such other place, and at such time and upon such terms, as the Trustee may fix and briefly specify in the notice of sale to be given as

herein provided; or (b) immediately upon the expiration of six months in the two cases so indicated, and immediately upon default in payment of principal, in the other case, may proceed to protect and enforce its rights and the rights of bondholders under this indenture, by a suit or suits in equity or at law, whether for the specific performance of any covenant or agreement contained herein, or in aid of the execution of any power herein granted, or for the foreclosure of this indenture, or for the enforcement of any other appropriate legal or equitable remedy, as the Trustee, being advised by counsel learned in the law, shall deem most effectual to protect and enforce any of its rights or duties hereunder.

Upon the written request of the holders of twenty-five (25) per cent. in amount of the prior lien bonds, in case of any such continuing default, it shall be the duty of the Trustee, upon being indemnified as hereinafter provided, to take all needful steps for the protection and enforcement of its rights and the rights of the holders of the prior lien bonds, and to exercise the powers of entry of sale herein conferred, or both, or to take appropriate judicial proceedings by action, suit or otherwise, as the Trustee, being advised by counsel learned in the law, shall deem most expedient in the interest of the holders of the prior lien bonds.

When a sale is to be made under the provisions of this Article, the Mexican Mortgage will define the procedure under the laws of the Republic of Mexico by which such sale may be made. It is not intended that the provisions of the Mexican Mortgage shall be exclusive hereof, but only supplementary hereto; provided, however, that if it shall be necessary in order to convey to the purchaser or purchasers of the mortgaged premises or any part thereof, a good and valid title thereto and to deliver possession thereof, that the sale should be made in the

Republic of Mexico and pursuant to the laws thereof, then such sale shall be made in accordance with the provisions of the Mexican Mortgage, but the provisions of the Mexican Mortgage shall not apply to the sale of any personal property subject to the lien hereof unless the Trustee shall elect to resort to the provisions thereof, and of the Mexican law for the sale thereof.

SECTION 5. Anything in this indenture contained to the contrary notwithstanding, the holders of seventy-five (75) per cent. in amount of the prior lien bonds outstanding from time to time, shall have the right to direct and to control the method and place of conducting any and all proceedings for any sale of the premises hereby conveyed, mortgaged or pledged, or for the foreclosure of this indenture or of the Mexican Mortgage, or for the appointment of a receiver, depositary or interventor or for any other proceedings hereunder.

EXHIBIT C: LETTER FROM WILLIAM B. DODGE,
DATED OCTOBER 22, 1982

MANUFACTURERS HANOVER TRUST COMPANY
40 WALL STREET, NEW YORK, N.Y. 10015

October 22, 1982

Edward M. Sills, Esq.
225 Broadway
New York, New York 10007

Re: Texas-Mexican Railway Company

Dear Mr. Sills:

In your letter of October 7, 1982 you asked several questions with respect to the proposed sale of the Texas-Mexican Railway Company and related real property in Laredo, Texas (the "Collateral") by Manufacturers Hanover Trust Company, as Successor Trustee under the Prior Lien Mortgage, dated March 15, 1902, of National Railroad Company of Mexico to Union Trust Company of New York, as Trustee (the "Mortgage"). Following is Manufacturers Hanover's response to your questions:

1. Are you acting as Trustee or in any capacity at the present time for holders of any other mortgage or securities whose collateral or other security for payment may be affected by this foreclosure sale?

Manufacturers Hanover is acting as Successor Trustee under the following mortgages which are secured in whole or in part by the Collateral:

a. The Mortgage, providing for the issuance of up to \$23,000,000 of Prior Lien Four and One-Half

Per Cent. Gold Bonds (the "Bonds").

b. Consolidated Mortgage of National Railroad Company of Mexico to Central Trust Company of New York, Trustee, dated March 15, 1902, providing for the issuance of up to \$30,000,000 of First Consolidated Mortgage Four Per Cent. Gold Bonds.

c. Prior Lien Mortgage of Ferrocarriles Nacionales de Mexico to Central Trust Company of New York, Trustee, dated June 22, 1908, providing for the issuance of up to \$225,000,000 of Prior Lien Four and One-Half Per Cent. Fifty-Year Sinking Fund Redeemable Gold Bonds.

In addition, Manufacturers Hanover is acting as Successor Trustee under the following:

d. Prior Lien Mortgage of the Mexican International Railroad Company to the Union Trust Company of New York, dated August 6, 1897, providing for the issuance of up to 1,200,000 Pounds Sterling of Four and One-Half Per Cent. Prior Lien Sterling Bonds.

e. First Consolidated Mortgage of Mexican International Railroad Company to the Union Trust Company of New York, dated August 6, 1897, providing for the issuance of up to \$7,206,500 of Four Per Cent. Gold Bonds.

f. Trust Agreement of Ferrocarriles Nacionales de Mexico to Central Trust Company of New York, Trustee, dated June 2, 1913, providing for the issuance of up to 6,000,000 Pounds Sterling of Two Year Six Per Cent. Gold Notes.

The mortgage referred to in item f is in part secured by the pledge of Prior Lien Four and One-Half Per Cent. Fifty Year Sinking Fund Redeemable Gold Bonds issued under the mortgage referred to in item c, and is thus indirectly secured by the Collateral. The mortgages referred to in items d and e, above are not secured either directly or indirectly by the Collateral and accordingly, Manufacturers Hanover does not believe they will be affected by the proposed sale of the Collateral.

Further, Manufacturers Hanover is acting as Successor Trustee under the following Indentures, the securities listed under which Indentures are part of the Collateral:

- g. Indenture of The Texas-Mexican Railway Company to the Guarantee Trust and Safe Deposit Company and Louis H. Meyer, dated July 1, 1881, providing for the issuance of up to \$2,500,000 of 6% First Mortgage, 40 Year Gold Bonds.
- h. Indenture of Corpus Christi, San Diego and Rio Grande Narrow Gauge Railroad Company to the Farmers Loan and Trust Company, dated June 24, 1880, providing for the issuance of up to \$960,000 of 7% Gold Bonds.

2. (a) In connection with your minimum bid, on what basis would Prior Lien Four and One-Half Per Cent. Gold Bonds be acceptable to you in lieu of U.S. dollars? (b) Will you disqualify any such bonds owned or held by or for the issuing company, or any successor in interest thereto?

(a) Manufacturers Hanover, as Successor Trustee, will comply with Section 13 of Article Four of the Mortgage, which provides:

SECTION 13. In case of any sale as aforesaid, of

the mortgaged premises, any purchaser, for the purpose of making settlement or payment for the property purchased, shall be entitled to turn in any prior lien bonds and any matured and unpaid coupons, in order that there may be credited, as paid thereon, the sums payable out of the net proceeds, after allowing for the proportion of the total purchase price required to pay the costs and expenses of the sale, or otherwise; and such purchaser shall be credited, on account of the purchase price of the property purchased, with the sums payable out of such net proceeds on the bonds and coupons so turned in; and, at any such sale, any holders of the prior lien bonds may bid for, and purchase, such property, and may make payment on account thereof as aforesaid, and, upon compliance with the terms of sale, may hold, retain and dispose of such property without further accountability therefor.

(b) No. The Mortgage does not grant the Trustee the power to disqualify issued and outstanding Bonds.

3. Have you considered or taken any steps to assure the protection of any interests of subordinate bondholders whose status may be affected by a sale at this time?

Holders of the Bonds have exercised their right to instruct the Successor Trustee to sell the Collateral, as discussed under Question 4, below. Holders of any other securities secured by the Collateral will be entitled to receive the proceeds of sale of the Collateral to the extent such proceeds exceed the amount due the holders of the Bonds.

4. Are there any particular reasons for pursuing the remedy of foreclosure now, especially since it hasn't been

for so many years?

Section 5 of Article Four of the Mortgage provides:

SECTION 5. Anything in this indenture contained to the contrary notwithstanding, the holders of seventy-five (75) per cent in amount of the prior lien bonds outstanding from time to time, shall have the right to direct and to control the method and place of conducting any and all proceedings for any sale of the premises hereby conveyed, mortgaged or pledged, or for the foreclosure of this indenture or of the Mexican Mortgage, or for the appointment of a receiver, depositary or interventor or for any other proceedings hereunder.

Manufacturers Hanover, as Successor Trustee, has been instructed by the holders of more than 75% of the outstanding Bonds to foreclose the Mortgage and to sell the Collateral at a public auction on November 2, 1982, in Laredo, Texas.

Very truly yours,

s/

William B. Dodge

WBD:re

EXHIBIT D: LETTER FROM AZIOS AND
ASSOCIATES DATED MAY 12, 1982

J.M. Azios, President Rosie M. Azios, Vice President
AZIOS AND ASSOCIATES, INC. REALTORS

May 12th., 1982

Mr. Andres Ramos, President
Texas Mexican Railways Company
Convent and Washington
Laredo, Texas 78040

Dear Mr. Ramos:

In accordance with your request to estimate the market value of the non-operating properties of the Texas Mexican Railway Company as described on attached list, I respectfully offer the following:

After carefully considering and analyzing all factors that contribute to value, especially the effect of the present high interest rates and recent devaluation of the Mexican "Peso", plus the fact that most of this property is "limited purpose" property, it is the opinion of the appraiser that a fair market value for subject property as a "whole property" as of May 12th., 1982 was:

TWO MILLION, TWO HUNDRED FORTY-FIVE
THOUSAND DOLLARS.....(\$2,245,000)

I hereby certify that I have no financial interest present or contemplated, in the property, and that neither the employment to make the appraisal nor the compensation is contingent on the value reported.

Respectfully yours,

s/
JOE AZIOS
Real Estate Appraiser

**EXHIBIT E: AUDITED FINANCIAL STATEMENT
DATED JUNE 18, 1982**

THE TEXAS MEXICAN RAILWAY COMPANY

Audited Financial Statement

December 31, 1981

Ernst & Whinney

[End cover page]

**THE TEXAS MEXICAN RAILWAY COMPANY
Audited Financial Statements
December 31, 1981**

Audited Financial Statements

| | |
|---|----------|
| Auditors' Report | 1 |
| Balance Sheet | 2 |
| Statement of Income and Retained Earnings | 4 |
| Statement of Changes in Financial Position | 5 |
| Notes to Financial Statements | 6 |

(i)

ERNST & WHINNEY

1800 Victoria
Laredo, Texas 78040
512/722-6361

Board of Directors
The Texas Mexican Railway Company
Laredo, Texas

We have examined the balance sheet of The Texas Mexican Railway Company as of December 31, 1981, and the related statements of income and retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of The Texas Mexican Railway Company as of December 31, 1981, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

s/

Laredo, Texas
June 18, 1982

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THE TEXAS MEXICAN RAILWAY COMPANY
BALANCE SHEET
December 31, 1981

ASSETS

(In Thousands)

CURRENT ASSETS

| | |
|--|------------|
| Cash and certificates of deposit (\$8,260,000) | \$ 8,802 |
| Accounts receivable | 6,300 |
| Note receivable | 66 |
| Accrued interest receivable | 206 |
| Materials and supplies | 2,337 |
| Other | <u>292</u> |
| TOTAL CURRENT ASSETS | 18,003 |

PROPERTIES — Note B

| | |
|--------------------------------------|----------------|
| Equipment | 10,579 |
| Land and improvements | 12,323 |
| Accumulated depreciation (deduction) | <u>(5,783)</u> |

\$ 35,122

-2-

LIABILITIES AND SHAREHOLDER'S EQUITY

(In Thousands)

CURRENT LIABILITIES

| | |
|------------------------------------|---------------|
| Accounts payable | \$ 1,682 |
| Accrued labor and fringe benefits | 863 |
| Bonds payable in default — Note B: | |
| Principal | 2,340 |
| Interest | 6,486 |
| Amount due Mexico | 1,061 |
| Income taxes and other | 797 |
| Current portion of note payable | 40 |
| TOTAL CURRENT LIABILITIES | 13,269 |

PAYABLE — less portion classified

current liability 160

DEFERRED CREDITS

282

DEFERRED INCOME TAXES — Note C

2303

SHAREHOLDER'S EQUITY

STOCKHOLDERS' EQUITY

Common Stock, par value \$100 per share
authorized and issued 25,000 shares 2,500

Retained earnings — Note B

2,300
16,608

| | |
|-----------------------------------|-----------------------|
| TOTAL SHAREHOLDER'S EQUITY | 19,108 |
| | <small>10,000</small> |

CONTINGENCIES — Note E

\$ 35,122

See notes to financial statements

-3-

THE TEXAS MEXICAN RAILWAY COMPANY
 STATEMENT OF INCOME AND
 RETAINED EARNINGS
 Year Ended December 31, 1981

(In Thousands)

| | |
|--|-----------------|
| Operating revenue | \$25,600 |
| Operating expenses: | |
| Ways and structures | 2,439 |
| Equipment — Note D | 6,230 |
| Transportation | 7,649 |
| General and administration | <u>2,992</u> |
| | <u>19,310</u> |
| INCOME FROM OPERATIONS | 6,290 |
| Other income: | |
| Interest | 1,306 |
| Other | <u>532</u> |
| | <u>1,838</u> |
| Interest expense | <u>204</u> |
| INCOME BEFORE INCOME TAXES | 7,924 |
| Income taxes — Note C | |
| Current | 2,454 |
| Deferred | <u>1,083</u> |
| | <u>3,537</u> |
| NET INCOME | 4,387 |
| Retained earnings at beginning of year | <u>12,221</u> |
| RETAINED EARNINGS AT END OF YEAR | <u>\$16,608</u> |
| See notes to financial statements | |

STATEMENT OF CHANGES IN
FINANCIAL POSITION
Year Ended December 31, 1981

(In Thousands)

SOURCE OF FUNDS

| | |
|---|-----------------------|
| Net income | \$ 4,387 |
| Expenses not requiring outlay of funds: | |
| Depreciation | 644 |
| Deferred income taxes | <u>1,083</u> |
| | TOTAL FROM OPERATIONS |
| | 6,114 |

| | |
|---|------------|
| Decrease in note receivable | 14 |
| Decrease in other assets | 20 |
| Net book value of disposals of properties | 691 |
| Increase in accounts payable | 35 |
| Increase in amount due Mexico | 15 |
| Increase in deferred credit | <u>282</u> |
| | 7,171 |

APPLICATION OF FUNDS

| | |
|--|-----------|
| Increase in accounts receivable | 573 |
| Increase in accrued interest receivable | 96 |
| Increase in materials and supplies | 855 |
| Additions to properties | 2,323 |
| Decrease in accrued labor and fringe benefits | 50 |
| Decrease in income taxes and other liabilities | 1,518 |
| Decrease in current portion of notes payable | 754 |
| Decrease in long-term portion of note payable | <u>40</u> |
| | 6,209 |

INCREASE IN CASH AND
CERTIFICATES OF DEPOSIT

962

| | |
|--|-----------------|
| Cash and certificates of deposit at beginning of year | <u>7,840</u> |
| CASH AND CERTIFICATES OF DEPOSIT AT END OF YEAR | <u>\$ 8,802</u> |
| See notes to financial statements | |

THE TEXAS MEXICAN RAILWAY COMPANY
NOTES TO FINANCIAL STATEMENTS
December 31, 1981

NOTE A—SIGNIFICANT ACCOUNTING POLICIES

General: The financial statements include the accounts of The Texas Mexican Railway Company (TEX MEX), wholly owned by the Mexican government and approximately 80% of revenues result from shipments into or out of the Republic of Mexico. TEX MEX was originally incorporated in the State of Texas on March 13, 1875, and operates a 157 mile railway between Corpus Christi and Laredo, Texas.

Materials and Supplies Inventory: Inventories are stated at the lower of cost or market with cost being determined generally on the first-in, first-out basis.

Properties: Properties are stated principally at cost. Certain items of railroad property, principally track structures, are not depreciated but are accounted for under the alternative generally accepted accounting method of replacement accounting. Under this method, replacements are charged to expense and only additions or betterments are capitalized. Gains and losses on retirement of these items are included in operating expenses. Beginning in 1981, capitalized track structure (the frozen asset base) is being depreciated, for tax purposes only, over 5 years. Other properties are depreciated principally on the straight-line method for financial reporting purposes and on an accelerated basis for tax purposes. Upon sale or retirement of equipment and other depreciable property of the Railway Company, the cost of the asset less the sale proceeds is charged to accumulated depreciation.

Investment Tax Credits: Investment tax credits are accounted for by the flow-through method.

NOTE B—BONDS PAYABLE

TEX MEX is in default on the payment of principal and interest relating to the following bond issues:

| | <u>Principal</u> | <u>Interest</u> |
|--|------------------|-----------------|
| Corpus Christi, San Diego and Rio Grande Narrow Gauge Railroad Company 7% Bonds, issued June 24, 1880, maturity date July 1, 1910 | \$ 960,000 | \$3,495,000 |

[End of Page 6]

| | | |
|---|---------------------------|---------------------------|
| Texas Mexican Railway Company 6% Gold Bonds, issued July 1, 1881, maturity date July 1, 1921 | <u>\$1,380,000</u> | <u>\$2,991,000</u> |
| | <u><u>\$2,340,000</u></u> | <u><u>\$6,486,000</u></u> |

Interest accruing currently is being paid annually by TEX MEX and totaled \$150,000 for the year ended December 31, 1981. The bonds are collateralized by all of the real estate properties of TEX MEX. No dividends may be paid from retained earnings until the default has been cured.

NOTE C—FEDERAL INCOME TAXES

The provision for income taxes was less than the amount computed by applying the United States income tax rate

of 46% to income before tax primarily due to the utilization of investment tax credit (\$86,000).

Deferred tax expense of \$1,083,000 resulted from depreciation timing differences between earnings for income tax and financial reporting purposes.

NOTE D—LEASES

Rent expenses for net daily rental charges on Railway operating equipment amounted to approximately \$4,200,000 in 1981. All other operating leases are not material.

NOTE E—CONTINGENT LIABILITIES

Legal actions are pending against TEX MEX. Management and legal counsel believe that any ultimate liability will not materially affect the financial position of the Railway.

Additionally, in prior years TEX MEX claimed \$2,000,000 of investment tax credits relating to certain operating leases. Of this amount, \$1,344,000 is subject to recapture if the leases are terminated (recapture expiring \$682,000 in 1983 and \$662,000 in 1985).

EXHIBIT F: VALUATION DATED MAY, 1982
FIRST TWO SHEETS

THE TEXAS MEXICAN RAILWAY COMPANY

VALUATION

Confidential: Prepared solely for the use of the
Government of Mexico and its
Agencies

LEHMAN BROTHERS KUHN LOEB
INCORPORATED

MAY, 1982

[End cover sheet]

This is a confidential memorandum prepared solely for the use of the Government of Mexico and its Agencies. This memorandum has been prepared by Lehman Brothers Kuhn Loeb Incorporated ("LBKL") primarily from information received from The Texas Mexican Railway Company, and no independent verification of this material has been made by LBKL. LBKL makes no representations or warranties, expressed or implied, as to the accuracy or completeness of this confidential memorandum or any of its contents, and no legal liability is assumed or to be implied with respect thereto.

[End first (unnumbered) page]

EXHIBIT G: NOTICE OF SALE OF COLLATERAL
DATED AUGUST 10, 1982

NOTICE OF SALE

Sale of the
Texas-Mexican Railway Company
and related Real Property in
Laredo, Texas

For the holders of
National Railroad Company of Mexico
Prior Lien Four and one-half Per Cent Gold Bonds
Dated March 15, 1902

Notice is hereby given that Manufacturers Hanover Trust Company, as Successor Trustee under the Prior Lien Mortgage, dated March 15, 1902, of National Railroad Company of Mexico to Union Trust Company of New York, as Trustee (the "Mortgage"), will foreclose the Mortgage and sell as an entirety all the Mortgage collateral consisting of the following securities and other property:

1. US \$960,000 in aggregate principal amount of Corpus Christi, San Diego & Rio Grande Narrow-Gauge Railroad Company 7% Bonds due 1910.
2. US \$1,380,000 in aggregate principal amount of Texas-Mexican Railway Company 6% Bonds due 1921.
3. All the authorized and outstanding shares of the \$100 par value capital stock of Texas-Mexican Railway Company.

4. Real property in the Eastern Division of Laredo, Texas, included in the area bounded generally on the west by Sanders Avenue, on the north by Corpus Christi Street, on the east by Tilden Avenue, and on the southwest by the Rio Grande and including all or a portion of the following blocks: 011; 012; 013, 014; 015; 016; 017; 018; 019; 020; 1; 3; 4; 5; 6; 7; 8; 12; 13; 14; 15; 16; 17; 18; 19; 20; 21; 22; 29; 30; 32; 39; 40; 41; 42; 46; 47; 49; 50; 51; 52; 56; 57; 58; 60; 61; 62; 63; 64; 67; 68; 75; 76; 79; and 450-A, plus portions of Block Number 323 in the Western Division of Laredo, Texas.
5. That portion of the international railroad bridge between Nuevo Laredo, Tamaulipas, Mexico and Laredo, Texas, United States of America which is in the United States of America.

The sale will be at a public auction on Tuesday, November 2, 1982 at 10:30 a.m. in the ballroom of the La Posada Hotel, 1000 Zaragosa Street, Laredo, Texas. The sale will be made without covenant or warranty regarding title, possession or encumbrances for the purpose of paying the obligations secured by the Mortgage consisting of US \$81,704,625 due and owing on the Prior Lien Four and one-half Per Cent Gold Bonds and the fees and expenses of the Trustee under the Mortgage. The Mortgage was recorded in Webb County, Texas on November 28, 1902 in Vol. V, pp. 418 to 516 of Deed of Trust Records.

The minimum bid acceptable to the Trustee is US \$31,00,000 payable in cash or Prior Lien Four and one-half Per Cent Gold Bonds as provided in the Mortgage. The Trustee reserves the right: (i) to reject any and all bids; (ii) to adjourn the sale without notice; (iii) to

amend or supplement the terms of sale; and (iv) to reject the bid of any person to whom it determines the sale cannot be made legally, or if it determines the sale to such person would require the filing of a registration statement under the Securities Act of 1933. Further information concerning the property to be sold and the terms of sale is contained in materials for prospective bidders which may be obtained upon written request to the undersigned, accompanied by a cashier's check or money order in the amount of US \$250 which shall not be refundable.

Manufacturers Hanover Trust Company
as Trustee under the Prior Lien
Mortgage of National Railroad
Company of Mexico
40 Wall Street
New York, N.Y. 10015
Tel. No.: 212-623-7843

Dated: August 10, 1982

EXHIBIT H: LETTER FROM KELLEY DRYE &
WARREN BY EDWARD ROBERTS, III
DATED OCTOBER 5, 1982

KELLEY DRYE & WARREN
101 Park Avenue
New York, N.Y. 10178

October 5, 1982

CERTIFIED MAIL

Hubert Park Beck
523 West 121st Street
New York, New York 10027

Re: Public Sale of the Texas-
Mexican Railway Company

Dear Mr. Beck:

On behalf of Manufacturers Hanover Trust Company, the successor trustee under the Prior Lien Mortgage of the National Railroad Company of New York, dated March 15, 1902, we hereby call your attention to the Notice of Foreclosure and Public Sale which is enclosed with this letter.

Sincerely,

s/
Edward Roberts, III

ER:re
Enclosure

EXHIBIT I: NOTICE OF DISTRIBUTION
DATED DECEMBER 20, 1982

To the Holders of
**NATIONAL RAILROAD
COMPANY OF MEXICO**
Prior Lien 4 1/2 % Gold Bonds
dated March 15, 1902

Notice is hereby given that on and after December 27 1982, the undersigned, as Trustee under the Prior Lien Mortgage of National Railroad Company of Mexico dated March 15, 1902, will distribute \$1,355.00 per \$1,000 bond, on account of the interest accrued and unpaid on said Bonds as of December 27, 1982, from funds received on underlying collateral.

In respect of Bonds which have been stamped to indicate assent to the offer of the United States of Mexico's Agreement with the International Committee of Bankers on Mexico dated February 20, 1946, the amount of such distribution will be paid to The Chase Manhattan Bank, Successor Fiscal Agent of Mexico, in accordance with the assignments provided for in Article IX of said Agreement; and distribution will not be made to the holders of such assenting Bonds.

Holders on non-assenting Bonds may receive such distribution by presenting their Bonds for notation of such payment thereon at the appropriate office of the undersigned, as set forth below, accompanied by a letter of transmittal in form available upon request at such office and, in the case of foreign holders, accompanied by appropriate ownership certificates (U.S. Treasury Department Form 1001).

If Sent By Mail

Manufacturers Hanover Trust Co.
Corp. Trust Securities Processing
P.O. Box 1916
G.P.O. Station
New York, N.Y. 10016

or

If Delivered By Hand
Manufacturers Hanover Trust Co.
130 John Street
Street Level
New York, New York

Unclaimed funds are also available from the following prior distributions:

| | |
|----------------|--------------------|
| 1% payment | December 14, 1942 |
| 1% payment | September 17, 1945 |
| 4% payment | December 26, 1951 |
| 3-1/2% payment | April 28, 1954 |
| 2% payment | April 30, 1957 |
| 5% payment | April 15, 1965 |
| 5% payment | April 1, 1972 |
| 1-1/2% payment | May 15, 1975 |
| 3-1/2% payment | April 1, 1977 |
| 1% payment | December 15, 1978 |
| 2% payment | December 15, 1979 |
| 1% payment | December 15, 1980 |
| 23% payment | December 31, 1981 |

Bonds not stamped indicating receipt of these previous payments on account of interest should also be presented with appropriate transmittal letters, available upon request at the above-mentioned office of Manufacturers Hanover Trust Company.

MANUFACTURERS HANOVER
TRUST COMPANY
as Trustee

Dated: December 20, 1982
New York, N.Y.

EXHIBIT J: LETTER OF TRANSMITTAL FOR RECEIPT OF PAYMENT OR SALE OF COLLATERAL

LETTER OF TRANSMITTAL
NATIONAL RAILROAD COMPANY OF MEXICO
Prior Lien Four and One-half Per Cent Gold Bonds
Dated March 15, 1902

PAYMENT

NO.

14

PAYMENT

NO.

14

Date _____

Manufacturers Hanover Trust Company
Corporate Trust Department
40 Wall Street
New York, New York 10015
Attn: W. B. Dodge

GENTLEMEN:

Enclosed please find \$ principal amount of Bonds
of the above described issued numbered as follows, with
Cash Warrant No. and subsequent Cash Warrants
attached and Scrip Warrant No. and subsequent Scrip
Warrants attached.

(Please arrange and list Bond numbers in numerical
order—if more space is required use reverse hereof.)

The undersigned is presenting said Bond(s) for the
purpose of receiving a payment in the amount of
\$1,355.00 per \$1,000 Bond on account of the interest
accrued and unpaid thereon as of 12/27/82 and for
stamping said Bond(s) with the following notation of

such payment: "\$1,355.00 per \$1,000 p.a. (\$677.50 per \$500 p.a.) paid on account of interest accrued and unpaid hereon on to December 27, 1982."

The undersigned hereby certifies that the name and address of the owner of the Bond(s) enclosed herewith is as follows:

NAME—PLEASE PRINT

ADDRESS—PLEASE PRINT

Please issue your check for the amount of such distribution of interest payable to the order of, and return the Bond(s) enclosed herewith to

NAME

ADDRESS

By: Registered Mail
 Against counter receipt

SIGNATURE OF OWNER OR AUTHORIZED AGENT

By

AUTHORIZED OFFICER

(Do Not Write in This Space)

| Ticket | P. A. | | Payment | Check No. |
|---------|-----------|---------|-----------|-----------|
| Checked | Rechecked | (Stops) | Delivered | Date |

NOTICE

Bonds not stamped indicating receipt of previous payments on account of interest should be presented with appropriate transmittal letter or letters, available upon request at the office of Manufacturers Hanover Trust Company, in addition to this form.

EXHIBIT K: BANCO DE MEXICO, S.A.,
CERTIFICATION OF HOLDING OF
PRIOR LIEN BONDS

BANCO DE MEXICO, S.A.

REF. WSR/82M-193 -

The Banco de México hereby certifies that on the date hereof it is holding U.S. \$22,040,500 principal amount of the National Railroad Company of Mexico Prior Lien Four and one-half Per Cent Gold Bonds, dated March 15, 1092 (the "Bonds") on behalf of the United States of Mexico, the beneficial owner of the Bonds, bearing the serial number listed on Schedule I hereto.

BANCO DE MEXICO, S.A.

By s/

Name: Lic. Emilio Gutiérrez Moller
Title: Gerente General

By s/

Name: Ing. Héctor Reyes Retana
Title: Gerente General

EXHIBIT L: ASSIGNMENT, MEXICO TO
TRANSPORTACION MARITIMA MEXICANA, S.A.,
DATED NOVEMBER 2, 1982

[Printed "letterhead"]

SECRETARIA
DE
NACIENDA Y CREDITO PUBLICO

[Typed "letterhead"]

DIRECCION GENERAL DE CREDITO PUBLICO
Dirección de Deuda Pública
305-I-4658

FOR VALUE RECEIVED, the United States of Mexico hereby sells, assigns and transfers to Transportación Maritima Mexicana, S.A. all right, title and interest in the National Railroad Company of Mexico Prior Lien Four and one-half Per Cent Gold Bonds, dated March 15, 1902, bearing the serial numbers listed on Schedule I hereto and certified by the Banco de Mexico on the date hereof as held by the Banco de Mexico on behalf of the United States of Mexico, in the principal amount of U.S. Twenty-Two million, forty thousand, five hundred dollars (U.S. \$22,040,500.00), together with all interest coupons attached thereto.

DATED: November 2, 1982

UNITED STATES OF MEXICO
By s/

Name: C.P. Roberto Diéguez Armas
Title: Director de Deuda Pública

In the presence of
s/

EXHIBIT M: ASSIGNMENT, TRANSPORTACION
MARITIMA MEXICANA, S.A. TO MEXRAIL, INC.,
DATED NOVEMBER 2, 1982

TRANSPORTACION MARITIMA MEXICANA, S.A.
Ave. Cuauhtómoo No. 1230 México 13, D.F.

Telefono
559-96-22

Dirección Cablegrafica:
Mexmarim
Telex 017-73949

FOR VALUE RECEIVED, Transportacion Maritima Mexicana, S.A., hereby sells, assigns and transfers to Mexrail, Inc. all right title and interest in the National Railroad Company of Mexico Prior Lien Four and One-Half Per Cent Gold Bonds bearing the serial numbers listed on Schedule I hereto in the principal amount of U.S. Twenty Two Million, Fourty Thousand and Five Hundred dollars (U.S. \$22,040,500.00), together with all interest & coupons attached thereto.

Dated: November 2, 1982

By: s/

Name: Alejandro Rojas M.V.
Title: Managing Director

By: s/

Name: Eduardo De Campo C.
Title: Attorney-in-fact

In the presence of
s/

DEC 8 1987

JOSEPH F. SPANIOL, JR.
CLERK

5
No. 87-616

In the Supreme Court of the United States
OCTOBER TERM, 1987

HUBERT PARK BECK, DOROTHY FAHS BECK,
ROBERT J. BECK and OTTO WEINMANN,
Petitioners,

VS.

MANUFACTURERS HANOVER TRUST COMPANY;
MILBANK, TWEED, HADLEY & McCLOY;
KELLEY DRYE & WARREN; DONALD B. HERTERICH;
ISAAC SHAPIRO; and EDWARD ROBERTS, III,
Respondents.

SECOND SUPPLEMENTAL BRIEF TO
PETITION FOR WRIT OF CERTIORARI TO
THE UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

STUART HECKER, ESQ.
Attorney for Petitioners
521 Fifth Avenue
New York, New York 10175
(212) 682-7070



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(Please note: The pagination of the Appendix continues
from that found in the Supplemental Brief to the Petition
for Writ of Certiorari.)

FURTHER REASONS FOR ALLOWANCE OF THE WRIT

Petitioners respectfully submit this Second Supplemental Brief, pursuant to Rule 22.6 of this Court, to apprise the Court of recent developments in the Second, Third, Fourth, and Tenth Circuits relevant to its consideration of their petition for certiorari. Each of these developments underscores the necessity for the granting of the petition.

Second Circuit

In *Krantz v. Schlesinger*, No. CV-86-1637, slip. op. (E.D.N.Y. November 16, 1987) (text of opinion reproduced as Appendix Q), Chief Judge Weinstein dismissed a RICO complaint for failure to adequately plead the "continuing criminal enterprise requirement of RICO, ..." Slip op. at 2, 3; Appendix Q at 165A.

The complaint alleged that defendants had violated RICO by participating in a fraudulent scheme to abandon a condominium offering plan so that a subsequent plan could be submitted containing higher apartment prices. Plaintiffs were purchasers of apartments under the abandoned plan.

Citing the instant case and *United States v. Ianniello*, 808 F. 2d 184 (2d Cir. 1986), *cert. denied*, 107 S. Ct. 3229 & 3230 (1987), the Court held that even if the defendants' scheme had lasted for only a year, the complaint adequately alleged a pattern of racketeering activity. Slip. op. at 8, 9; Appendix Q at 170A.

However, citing *Beck, Ianniello, and Albany Insurance Co. v. Esses*, No. 86-7968, slip op. 5711 (2d Cir. October 15, 1987), the Court dismissed the complaint on the ground

that the "continuing enterprise requirement" was not satisfied: "The Second Circuit requires continuity for both the pattern of racketeering and the enterprise itself. An enterprise with a single purpose, such as fraud, can provide the basis for a Section 1962(c) violation only if the purpose has no obvious terminating goal or date ..." Slip op. at 6; Appendix Q at 169A. "[Here] plaintiffs allege an enterprise ... which defrauded plaintiffs and the Attorney General, and has ceased to function in terms of any criminal activity." *Id.* at 9; Appendix Q at 170A.

Chief Judge Weinstein's opinion accurately states the pattern/enterprise law in the Second Circuit. His dismissal of the complaint was compelled by the cases cited, which apply the Second Circuit rule that a single-purpose enterprise can commit a violation of §1962(c) only if its purpose has no obvious terminating goal or date.*

As is set forth in previous submissions on this petition, the Second Circuit rule (which has also been adopted by the Fifth Circuit) is violative of both the RICO statute and footnote 14 of this Court's opinion in *Sedima S.P.R.L. v. Imrex Company, Inc.*, 473 U.S. 479, 105 S. Ct. 3275 (1985).

* The Second Circuit's affirmance of the decision of the District Court was wholly predicated on the failure of the amended complaint to plead a continuing criminal enterprise under §1962(c). 820 F. 2d 46, 48; Appendix D at 28A. Completely ignored by the Second Circuit was the fact that the amended complaint contains ten RICO counts, covering, in the aggregate, *all* of the subsections of §1962. Only two of the counts allege violations of §1962(c). Given its holding that the amended complaint adequately pleads a pattern of racketeering activity, the Second Circuit should at the very least have reversed the District Court with respect to the eight counts not predicated upon §1962(c) violations.

In footnote 14 this Court singled out the term "pattern of racketeering activity" as "differ[ent]" from the other terms set forth in §1961, in that it alone, based on the statutory language and the contents of Senate Report No. 91-617, is susceptible of judicial interpretation. *Id.* at 496, n. 14. No justification for such interpretation exists with respect to "enterprise." The adversion of the Senate Report to "the factor of continuity plus relationship" is expressly limited to "pattern." The Second Circuit's "require[ment] of continuity for both the pattern and the enterprise itself" (*cf. Krantz v. Schlesinger, supra*, slip op. at 6; Appendix Q at 169A), finds absolutely no support in the Senate Report. It is thus grossly violative of both footnote 14 and the definition of "enterprise" in §1961(4).

The Second Circuit rule that a single-purpose enterprise can provide the basis for a violation of §1962(c) only if the enterprise is open-ended is also implicitly violative of §1962(b). That section, which proscribes the takeover of an enterprise through a pattern of racketeering activity, clearly contemplates that a "pattern" can exist for a single-purpose enterprise that has an obvious terminating goal: the achievement of the takeover.

It is clear from §1961(5) that, whatever "pattern" means, the same meaning must be applicable to all of the subsections of §1962, including §1962(c). Since there is no "open-endedness" requirement for a "pattern" under §1962(b), there can be none for §1962(c). The Second Circuit has expressly recognized this by its holding, in the instant case, that the amended complaint adequately alleges a "pattern."

In applying a standard of open-endedness to "enterprise" that does not exist for "pattern" the Second Circuit has engaged in a bootstrap process that stands the statute on its head. First that Court ascribes considerations of

continuity to "enterprise," and predicates its right to do so on this Court's dictum regarding "pattern" in footnote 14 of *Sedima* and the Senate Report on which it is based. In so doing, that Court ignores the fact that the continuity considerations of both footnote 14 and the Senate Report are expressly limited to "pattern," and that there is no support in either for their application to "enterprise." Finally, it completes the *tour de force* by reading "continuity," in its application to "enterprise," to include an open-endedness requirement that it admits, by its holding in this case, is precluded by the statute even in regard to "pattern." This is judicial interpretation run amok; it so far transcends the permissible construction of the statute that a summary reversal of this case is warranted under Rule 23.1 of this Court.

Third, Fourth and Tenth Circuits

The rules of the Second and Fifth Circuits, which erroneously conflate "enterprise" with the racketeering activity that is the operational object of RICO, may perhaps be viewed as anomalies. But the question of whether a single-purpose scheme must be open-ended to constitute a "pattern" has recently been considered by the Third, Fourth, and Tenth Circuits, with totally irreconcilable results.

In *Barticheck v. Fidelity Union Bank/First National State*, 56 U.S.L.W. 2260 (November 10, 1987), No. 86-5870, slip op. (3rd Cir. October 29, 1987), (to be reported at 832 F.2d 36; text of opinion reproduced as Appendix P), the Third Circuit rejected an open-endedness requirement for a single-purpose scheme. The Court stated (56 U.S.L.W. at 2260, slip op. at 8-9; Appendix P at 162A):

"We also reject the view that racketeering acts committed pursuant to a single

scheme can constitute a RICO pattern only if the scheme is potentially ongoing or open-ended. This requirement is ostensibly derived from the statement in RICO's legislative history, highlighted in *Sedima*, that a pattern must display "continuity" among the various acts of racketeering. See *Sedima*, 473 U.S. at 496 n. 14 (quoting S. Rep. No. 617, 91st. Cong., 1st Sess. 158 (1969)). We do not believe, however, that the notion of continuity compels a requirement of "open-endedness." At the very least, such a requirement would produce anomalous results. This approach would allow a party to maintain a RICO claim if he brought suit before the unlawful scheme had attained its objective; in such a case the scheme would presumably be considered open-ended. The same interpretation, though, would deny a RICO cause of action in a case where the scheme had fully accomplished its goal. Yet it is the completed scheme that inflicts the greater harm and more strongly implicates the remedial purposes of RICO.

We read the legislative history's references to "continuity" as simply calling for an inquiry into the extent of the racketeering activity. Although temporal open-endedness may be one measure of extent, it is not the only one"

The opposite conclusion was reached in *Eastern Publishing and Advertising, Inc. v. Chesapeake Publishing and Advertising, Inc.*, No. 87-1520, slip op. (4th Cir. October 16, 1987) (to be reported at 831 F. 2d 488; text of opinion reproduced as Appendix O); and in *Garbade v. Great Divide*

Mining & Milling Corp., No. 86-2544, slip op. (10th Cir. October 15, 1987) (to be reported at 831 F. 2d 212; text of opinion reproduced as Appendix N).

In each of these cases the Circuit Court affirmed the dismissal of RICO claims on the ground that they involved single-purpose schemes that had terminated at the inception of the actions. The decision in each case was predicated upon the Court's perception of the meaning of footnote 14 of *Sedima*.

In neither opinion did the Court deal with the question of whether its holding had implicitly read §1962(b) out of the statute; or, if §1962(b) continued to exist, whether the Court was violating §1961(5) by applying different standards for "pattern" to the various subsections of §1962.

In each of these cases the plaintiff would have prevailed, on the authority of *Barticheck*, if the action had been brought in the Third Circuit.

CONCLUSION

"Pattern" litigation in the Federal Courts is in a state of chaos. The outcome of any particular case is completely dependent on the Circuit in which it happens to have been brought. The "pattern" rules of each Circuit are in direct conflict with those of other Circuits. The provisions of the statute are being widely violated, and footnote 14 egregiously misinterpreted.

The worst offenders are the Second and Fifth Circuits, which have taken a giant step beyond any of the others by erroneously applying "pattern" considerations to the term "enterprise."

For the foregoing reasons, and those set forth in previous submissions, it is imperative that this Court grant the petition for a writ of certiorari.

Respectfully submitted,

Stuart Hecker
Attorney for Petitioners
521 Fifth Avenue
New York, New York 10175
(212) 682-7070

APPENDIX N

**OPINION OF THE UNITED STATES COURT OF
APPEALS FOR THE TENTH CIRCUIT IN GARBADE
V. GREAT DIVIDE MINING AND MILLING
CORPORATION, NO. 86-2544, SLIP OP.
(10TH CIR. OCTOBER 15, 1987)
(TO BE REPORTED AT 831 F. 2D 212)**

**UNITED STATES COURT OF APPEALS
TENTH CIRCUIT**

No. 86-2544

ALBERT M. GARBADE, JR., on behalf
of himself and all other stockholders of
Great Divide Mining and Milling Cor-
poration,

Plaintiff-Appellant,

v.

GREAT DIVIDE MINING AND MILL-
ING CORPORATION, a Colorado
corporation, and MILTON M. LEVIN,
Defendants-Appellees.

Appeal From the United States District Court For The
District of Colorado (D.C. Civil No. 85-K-2191)

G. Robert Blakey of McGuire, Cornwell & Blakey, P.C. (F.
Kelly Smith, with him on the brief), Denver, Colorado, for
Plaintiff-Appellant.

John R. Henderson of Vranesh and Raisch, Boulder,

Colorado, for Defendants-Appellees.

Before: SEYMOUR, SETH and BALDOCK,
Circuit Judges

SETH, *Circuit Judge*:

The defendant Great Divide Mining and Milling Corporation, a Colorado corporation, held several mining claims. It was organized by plaintiff's father who loaned it money from time to time. The defendant Levin later became the majority stockholder and he also loaned money to Great Divide beginning in the 1960s. He may have accepted shares of stock as payment for some of his loans. In 1976 Great Divide leased mining claims to Noranda Exploration for annual payments. This was apparently the first source of income for Great Divide for a long time. Mr. Garbade, Sr. and defendant Levin, then the Vice President, both wanted this to be applied in payment of their loans made to the company. Shortly thereafter, Mr. Garbade, Sr. died leaving Mr. Levin as the principal officer, majority stockholder and a director.

Thereafter as the lease payments were received by the company, Levin would apply the funds to repay his loans and intended to continue until he was repaid in full with interest. He later negotiated an additional lease of corporate claims with a Mr. Baumgartner which generated more income to Great Divide, which he then applied to the same purpose.

The applications of corporate funds were made secretly and without the knowledge or concurrence of other stockholders. It is this secret withdrawal of corporate income which the plaintiff asserts was illegal and constituted the fraud upon which the RICO and pendent state fraud claims were based.

The trial court dismissed the corporate defendant, Great Divide, entered summary judgment for defendant Levin, and dismissed the state claims. The court concluded that there was asserted nothing to constitute a "pattern of racketeering activity" by defendant Levin, 18 U.S.C. §1961(5); that there was no §1962(a) violation arising from the withdrawal of funds from the corporation; and that under §1962(c) and §1962(a) in these circumstances the corporation would not be both an "enterprise" and a "person." The plaintiff has appealed.

The appellant alleged that the acts of defendant Levin violated 18 U.S.C. §1962(a). This section is concerned with the use of funds derived from a "pattern of racketeering activity" to acquire interests in, or invest in, or to operate legitimate enterprises. The complaint was directed to asserted fraudulent withdrawal of funds from the corporation and not to investments in the concern. There were no facts to support an assertion that the funds loaned to the corporation were from a source described in §1962(a) nor used for the prohibited purposes.

The complaint further alleges that the corporate defendant, Great Divide, violated 18 U.S.C. §1962(c). The trial court dismissed the corporation on the ground that it could not in these circumstances be both an "enterprise" and a "person" within the purposes and wording of the section. We must agree. Section 1962(c) makes it unlawful for a "person" to enter the activities of an "enterprise" using racketeering activities. References are to "employed by" and "associated with." The section does not relate to corporate or enterprise liability. *Schofield v. First Commodity Corp.*, 793 F. 2d 28 (1st Cir.); *Haroco, Inc. v. Amer. Nat'l Bank & Trust Co.*, 747 F. 2d 384 (7th Cir.); *United States v. Computer Sciences Corp.*, 689 F. 2d 1181 (4th Cir.).

There is no indication whatever that the corporation was in any way benefited by the alleged acts of any defendant. The existence of such benefits have provided, in several cases, an exception to this conclusion and to impose corporate liability under §1962(a).

As the the claim of corporate liability under §1962(a), the trial court dismissed the corporate defendant. Again we agree. The "person" and "enterprise" combination liability can only occur when the corporation actually is the direct beneficiary of the pattern of racketeering activity, *Haroco, Inc. v. Amer. Nat'l Bank & Trust Co.*, 747 F. 2d 384 (7th Cir.); also, where it is to disgorge illegally obtained proceeds, *Masi v. Ford City Bank & Trust Co.*, 779 F. 2d 397 (7th Cir.); or where the statute seeks to reach the proceeds of illegal activities, *Schreiber Distributing Co. v. Serv-Well Furniture Co.*, 806 F. 2d 1393 (9th Cir.).

In the case before us the defendant corporation received no illegally obtained funds as contemplated by the statute. Its dismissal by the trial court was proper.

This brings us to the §1962(c) claim against the defendant Levin and more particularly to the issue of whether there was shown to be "a pattern of racketeering activity." In our view, when *Torwest DBC, Inc. v. Dick*, 810 F. 2d 925 (10th Cir.), is applied to these facts and circumstances the conclusion must be reached that the statutory requirements for such a §1962(c) claim were not met.

Torwest decided what was not a pattern of racketeering activity, as did *Condict v. Condict*, 815 F. 2d 579 (10th Cir.). We will do the same and again not attempt to construct an affirmative definition of what would constitute such a pattern. Thus as was said in *Torwest*:

"In reaching this conclusion, we decline to

go beyond the facts before us to formulate a bright-line test in the abstract."

As the description of the facts recited, the defendant Levin made the several secret withdrawals in an attempt to have the loans he had made to the company repaid out of company funds which he could control as a first priority. This method of securing repayment was to continue until the loan, with interest, had been repaid and nothing more. Thus there existed a clear and definite single objective for his acts.

This would seem to fit well into the holding in *Torwest* as to the scheme there concerned:

"[T]o achieve a single discrete objective does not in and of itself create a threat of ongoing activity, even when that goal is pursued by multiple illegal acts, because the scheme ends when the purpose is accomplished."

The Court in *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, referred to the purpose of the statute as one to meet "the threat of continuing activity" and not "sporadic activity." The elements required are described in *Torwest* and in its analysis of *Sedima*. In *Torwest* and here there is nothing from which there could be inferred a continuing scheme. The continuity element is absent here.

We have examined the arguments of appellant in regard to the Baumgartner lease on a portion of the corporate property which was negotiated and signed by the defendant Levin. He was then apparently the only corporate officer. We cannot conclude that this lease, nor the circumstances surrounding it, add any additional elements to the case relative to the issues raised and need

no separate discussion.

We thus agree with the action of the trial court in granting summary judgment for the defendant Levin and in the dismissal of the corporate defendant.

The judgment of the trial court is AFFIRMED.

APPENDIX O

**OPINION OF THE UNITED STATES COURT OF
APPEALS FOR THE FOURTH CIRCUIT IN
EASTERN PUBLISHING AND ADVERTISING, INC.,
V. CHESAPEAKE PUBLISHING AND
ADVERTISING, INC., NO. 87-1520, SLIP OP.
(4TH CIR. OCTOBER 16, 1987)
(TO BE REPORTED AT 831 F. 2D 488)**

**UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT**

No. 87-1520

EASTERN PUBLISHING AND ADVER-
TISING, INC., (A Close Corporation),
t/a "ARMED FORCES NEWS",
Plaintiff-Appellant,

versus

CHESAPEAKE PUBLISHING AND
ADVERTISING, INC., (A Close Corpo-
ration), t/a "THE MILITARY NEWS";
KAREN A. HORN, KIMBERLY J.
HORN; CAROL WHITNEY ANSELL,
DELLA LEMMINGS; ALFRED E. CLA-
SING, III; RAYMOND J. CANNOLES;
LOUISE MARTINS,
Defendant-Appellees.

Appeal from the United States District Court for the
District of Maryland, at Baltimore. J. Frederick Motz,
District Judge. (CA-86-1653-JFM)

Argued: June 29, 1987. Decided: October 16, 1987

Before: PHILLIPS, ERVIN, and WILKINSON, *Circuit Judges*

William Edward Seekford for Appellant; John Joseph Kuchno (Henry R. Lord; Piper & Marbury; Charles Martinez; Eccleston & Seidler on brief) for Appellees.

PHILLIPS, *Circuit Judge*:

Appellant Eastern Publishing and Advertising, Inc. (Eastern), appeals the Rule 12(b)(6) dismissal of its claims against a competing publisher, Chesapeake Publishing and Advertising, Inc. (Chesapeake), former Eastern employees, and former associates in the law firm that represents Eastern, alleging copyright infringement and RICO and antitrust violations. We affirm the dismissal of the copyright claim because Eastern failed to attach the requisite notice to the advertisements and to the issues of its newspaper, "Armed Forces News," on which it claims copyrights. We also affirm dismissal of the civil RICO and antitrust claims on the grounds relied upon by the district court.

I

Eastern publishes a quarterly newspaper, "Armed Forces News," which is directed to military personnel and their dependents and which consists of original advertising and publicly available government press releases. Chesapeake publishes a competing paper, "The Military News." Claiming that its publication is entitled to copyright protection as a "compilation" under 17 U.S.C. §§101, 103, even though the government publications that make up the newspaper are not themselves copyrightable, 17 U.S.C. §101, Eastern claimed that

Chesapeake infringed its copyrights in two issues of the "Armed Forces News," Volume V, Number III and Volume VI, Number IV. Eastern also claimed that Chesapeake infringed valid copyrights in individual advertisements appearing in those same issues. Volume V, Number III first was published on March 22, 1986, and Volume VI, Number IV on March 27, 1986. Eastern registered copyrights in these materials on May 9 and May 20, 1986, respectively. Copyright notices appeared on subsequent issues of the publication. No copyright notices appeared on the advertisements.

Appellees Karen Horn, Kimberly Horn, Carol Ansell, and Della Lemmings were employees of Eastern until April 1986. Appellees Alfred Clasing and Raymond Cannoles, worked with the law firm retained by Eastern before formation of Chesapeake; appellee Louise Martins currently works with Clasing and Cannoles. Clasing, Cannoles, and Martin are Chesapeake directors, and Karen Horn is the company's registered agent. According to Eastern's complaint, the various named defendants were responsible for photocopying, cutting apart, and reassembling Volume V, Number III and Volume VI, Number IV of "Armed Forces News" to create and publish "The Military News." Eastern further alleged that unidentified defendants represented to Eastern's advertising customers that Chesapeake was connected to Eastern and that the customers could renew their advertisements in Eastern's publication through Chesapeake. These customer contacts were alleged to have taken place through the mails and by interstate wire and telephone transmissions on various occasions during March, April, and May 1986.

In addition to claiming that publication of "The Military News" infringed Eastern's copyrights, Eastern charged that Chesapeake's exploitation of its customers

led to a decline in the number of "Armed Forces News" customers, while the number of Chesapeake's customers increased to the point that Chesapeake now controls the relevant market. Thus, according to Eastern, Chesapeake's activities have injured competition in violation of federal antitrust laws, 15 U.S.C. §§1-15. Eastern did not allege before the district court that any other competitor beside itself had been injured, but on appeal Eastern submits that at least three other competitors exist and that at least one of these has been injured competitively. Finally, Eastern charged Chesapeake with civil RICO violations for having committed multiple acts of mail and wire fraud in misleading Eastern's customers into publishing advertisements in "The Military News."

In ruling on appellees' 12(b)(6) motion, the district court found: (1) there was no copyright infringement because defendant's publication amounted to a recompilation of the copyrighted issues of "Armed Forces News"; (2) there was no "pattern" of racketeering activity to support the RICO claim; and (3) the facts alleged did not demonstrate the injury to competition required for an antitrust claim.

This appeal followed.

II

Eastern claims copyright in two separate sets of material: (1) advertisements published in "Armed Forces News"; and (2) two particular issues of the newspaper, Volume V, Number III and Volume VI, Number IV. To succeed on a copyright claim, one asserting copyright protection must have registered the copyright, 17 U.S.C. §411(A); *Conan Properties, Inc. v. Mattel, Inc.*, 601 F. Supp. 1179, 1182 (S.D.N.Y. 1984); *International Trade Management, Inc. v. United States*, 553 F. Supp. 402 (Ct. Cl. 1982),

and must also have attached notice of copyright on all publicly distributed copies of the protected item. 17 U.S.C. §401(a); *e.g., M. Kramer Manufacturing Co. v. Andrews*, 783 F. 2d 421, 443 (4th Cir. 1986).

No notice appeared on the individual advertisements. 17 U.S.C. §404(a) permits a copyright notice on a compilation of work as a whole to cover individual parts of the whole, unless the individual part is an advertisement for the benefit of someone other than the holder of the copyright in the entire collective work. A newspaper claiming copyright ownership in an advertisement prepared for another must give specific and separate notice of its copyright in the advertisement. *See Canfield v. Ponchotoula Times*, 759 F. 2d 493 (5th Cir. 1985). Therefore, even if notice of copyright was affixed properly to the newspaper to cover the publication as a whole, that notice would not cover the individual advertisements, and there can be no copyright infringement as to them.

There also was no notice on the two issues of "Armed Forces News" for which copyrights were registered on May 9 and May 20, 1986. Assuming these issues were copyrightable as "compilations," which are selections or arrangements of even uncopyrightable material in an original way, *see Southern Bell Telephone and Telegraph Co. v. Associated Telephone Directory Publishers*, 756 F. 2d 801, 809 (11th Cir. 1985), the registered copyrights lend no protection to Eastern unless the failure to place notice upon them is excused under 17 U.S.C. §405(a). Section 405(a)(2) excuses omission of notice if

registration for the work has been made before or is made within five years after the publication without notice, and a reasonable effort is made to add notice to all copies or phonorecords that are distributed to the

public in the United States after the omission has been discovered.

Eastern, having registered copyrights in the March 22 and March 27 issues on May 9 and May 20, and having placed general copyright notices on subsequent issues of the "Armed Forces News," claims that its copyright is preserved by the §405(a)(2) excuse.

The district court declined, in dictum, to excuse the failure to give notice under §405(a)(2) because it believed this section of the Copyright Act "is most clearly applicable to products identical to one another which are in continuous production," citing *Original Appalachian Art-works, Inc. v. Toy Loft*, 684 F. 2d 821, 826-27 (11th Cir. 1982) (dolls); *Shapiro & Son Bedspread Corp. v. Royal Mills Associates*, 568 F. Supp. 972, 976-77 (S.D.N.Y. 1983) (bedspreads); *Beacon Looms, Inc. v. S. Lichtenberg & Co.*, 552 F. Supp. 1305 (S.D.N.Y. 1982) (curtains); but cf. *Canfield*, 759 F. 2d 493 (considering the §405(a)(2) exception in a case involving newspapers). Our research reveals only one case in which §405(a)(2) has been invoked to preserve copyright protection for an article that is not in constant production, *Werlin v. The Reader's Digest Association*, 528 F. Supp. 451, 461 (S.D.N.Y. 1981), and we decline to follow its lead on the facts of this case. We therefore agree with the district court that §405(a)(2) does not apply unless there is continuous production of identical products, and for reasons that follow, we think that was not shown here.

Here, Eastern has claimed a copyright in two specific issues of its publication, each of which necessarily had not only a limited period of distribution but also a very limited lifespan in the hands of a consumer. Subsequent notice placed upon later, different issues of "Armed Forces News" is ineffective to alert others that copyrights cover earlier issues. It is also impossible for Eastern to

attach notice to the issues in question and thereby to comply literally with the second prong of §405(a)(2).

Cases considering the related question whether one claiming protection under §405(a)(2) must place notices of copyright on products already distributed to customers or only on products still in the hands of a retail seller support this conclusion. *See, e.g., M. Kramer*, 783 F. 2d at 444; *Donald Frederick Evans and Associates, Inc. v. Continental Homes*, 785 F. 2d 897, 911 n. 22 (11th Cir. 1986). Whatever their particular conclusions, these cases, like those construing the "reasonable effort" required by §405(a)(2) must have continued distribution, at least from a retailer, as well as continued use in the hands of a consumer or retailer. That simply is not the case with respect to the discrete issues of newspapers for which protection is sought here. These products obviously do not have those essential aspects.

Because the savings provision of §405(a)(2) does not apply here, Eastern's failure to give notice is not excused, and the two publications of "Armed Forces News" do not merit copyright protection.

III

We also agree with the district court's dismissal of Eastern's civil RICO claim. The essential elements of this type of RICO claim are: (1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity. *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 496 (1985). The racketeering activities upon which Eastern's claim is based are mail and wire fraud allegedly committed when appellees solicited appellant's advertising customers, misrepresenting that they were working on behalf of the "Armed Forces News." The district court found that these instances of mail and wire fraud did not establish the

requisite "pattern" for a successful RICO claim.

We think decision here is controlled by our interpretation and application of the "pattern" requirement in *International Data Bank, Ltd. v. Zepkin*, 812 F.2d 149 (4th Cir. 1987). In that case, drawing on the Supreme Court's recognition in *Sedima*, 473 U.S. 479, that more careful adherence by the courts to this requirement might properly limit civil RICO claims to their proper scope, we concluded that "no mechanical test can determine the existence of a RICO pattern," and that the question is necessarily a "matter of criminal dimension and degree" to be decided on a case-by-case basis. *Zepkin*, 812 F.2d at 155. The touchstone for assessing this we thought was revealed by the legislative history's emphasis that what was targeted was "not sporadic activity" but continuity or the threat of continuity of racketeering activity. *Id.* at 154. On this basis, we concluded that as a general proposition "a single, limited fraudulent scheme," notwithstanding it might include the requisite minimal number of sufficiently related predicate acts would not constitute the "pattern" of racketeering activity contemplated by Congress. *Id.* Such a single, limited scheme we thought was not the kind of "ongoing unlawful activities whose scope and persistence pose a special threat to social well-being." *Id.* While we recognized that a scheme properly considered to be a "single" one might by virtue of its very size and continuity meet the test, we thought the typical fraudulent schemes, limited in occurrence, in scope, and in purpose, that have been the traditional subjects of state tort law were not intended to be swept into RICO's reach by Congress. *Id.*

On this basis we concluded that a RICO complaint by investors alleging as predicate acts two violations of the securities laws in connection with the sale of securities did not sufficiently allege a pattern of RICO activity. We

held that the conduct charged was instead merely that of a "single, limited scheme" to defraud. Though it met the technical requirements of predicate acts sufficiently related to each other, it failed to charge the kind and degree of continuous engagement in criminal conduct required to constitute a RICO "pattern."

We think exactly the same analysis applies to the conduct charged here. The predicate mail and wire fraud acts charged are sufficient in number. They are sufficiently related in allegedly furthering Chesapeake's efforts to gain a competitive edge over Eastern. But in the end all that results is a single, non-recurring scheme to defraud a single entity by taking unfair competitive advantage in a quite narrow business context. There is no inference that the scheme embodies a threat of continued like activity in the future. Just as the scheme alleged in *Zepkin* was found wanting in the required degree of continuity of conduct, so is that here. The complaint fails to allege a RICO pattern of racketeering activity. *See Medallion TV Enterprises v. SELECTV of California, Inc.*, 627 F. Supp. 1290, 1296-97 (C.D. Cal. 1986) (series of calls and letters over a two-month period constitutes a single criminal episode, not a "pattern of activity"); *Phelps v. Wichita Eagle-Beacon*, 632 F. Supp. 1164, 1171-72 (D. Kan. 1986) (several telephone conversations and mailings in furtherance of a single ongoing scheme to harm plaintiff not a RICO "pattern"); *Grant v. Union Bank*, 629 F. Supp. 570, 578 (D. Utah 1986) (multiple mail and wire conviction in furtherance of single fraudulent loan scheme not a RICO pattern); *cf. Temporaries, Inc. v. Maryland National Bank*, 638 F. Supp. 118 (D. Md. 1986) (recognizing that single open-ended scheme might be so extensive in potential scope as to constitute pattern); *see also HMK Corp. v. Walsey*, ___ F.2d ___, No. 86-3582 (4th Cir. Sept. 17, 1987) (applying *Zepkin* to find no pattern in single scheme extending over long period and involving many

predicate acts aimed at corrupting political processes to gain competitive advantage).

IV

Eastern's antitrust claim is based upon the defendants' acts of copyright infringement and appropriation of confidential business information. The district court held this not to be the type of conduct at which the antitrust laws are aimed, and we agree. *See Bunker Ramo Corp. v. United Business Forms, Inc.*, 713 F. 2d 1272, 1283 (7th Cir. 1983). Moreover, the antitrust laws are inapposite here because the only damage is to Eastern as a competitor; there is no alleged injury to competition in the relevant market. *See id.*, at 1284-85; *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977) Eastern complains on appeal that in finding no injury to competition, the district court erroneously believed that there were no competitors in the market other than Eastern and Chesapeake. The court noted that before the creation of Chesapeake, there was only one market entity, Eastern, and that if events transpire as Eastern predicts, there will only be one market entity, Chesapeake. Therefore, there was no injury to competition. Eastern now avers for the first time that there are other competitors who are also harmed by Chesapeake's activities. We decline to take into account these other alleged competitors because their existence and injury were not averred in the complaint nor in any way suggested to the district court.

AFFIRMED.

APPENDIX P

DECISION OF THE UNITED STATES COURT OF
APPEALS FOR THE THIRD CIRCUIT IN
**BARTICHECK V. FIDELITY UNION BANK/FIRST
NATIONAL STATE, NO. 86-5870, SLIP OP.**
(3D CIR. OCTOBER 29, 1987), 56 U.S.L.W. 2260
(NOVEMBER 10, 1987)
(TO BE REPORTED AT 832 F. 2D 36)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 86-5870

JOHN E. BARTICHECK, DAVID CARMEL,
EMPIRE EMBLEM CO., MELVIN GITTLE-
MAN, MARK GORDON, ELLIE GORDON,
DANTE GRECO, WALTER HIRSCHINGER,
THEODORE KAHN, MURIEL KAHN,
STANLEY LOW, PETER MARTIN, ELISSA
MARTIN, DIANE C. NATOLI, HOBART
RAUCH, HOWARD M. SHIFFMAN, ROBERT
R. SCHWARTZ, JOHN J. VAS, GARY
WOLKOWITZ, SARAH WOLKOWITZ, AL
ATTERMAN, ABRAHAM SCHLUSSEL, and
MORTON GOETZ,

Appellants,

v.

FIDELITY UNION BANK/FIRST NATIONAL
STATE, a national banking association, GARY
FLAKER, and KEVIN SHANLEY,

Appellees,

and

JAMES D. DEMETRAKIS, STEPHEN P. SINISI,
and DEMETRAKIS, SINISI & CARMEL, ESQS.,

*Additional Defendants
on Counterclaim.*

Appeal from the United States
District Court for the
District of New Jersey
(D.C. Civil No. 86-201)

Argued August 3, 1987
Before: SEITZ, MANSMANN, and
GREENBERG, *Circuit Judges*
(Opinion Filed October 29, 1987)

George B. Gelman, Esq.
Philip L. Guarino, Esq. (Argued)
Gelman & McNish
411 Hackensack Avenue
Hackensack, New Jersey 07601

Attorney for Appellants

Harvey D. Myerson, Esq.
Mark E. Segall, Esq. (Argued) 66H
Finley, Kumble, Wagner, Heine, Underberg,
Manley, Myerson & Casey
425 Park Avenue
New York, New York 10022

Gerald A. Liloia, Esq.
Riker, Danzig, Scherer, Hyland & Perretti
Headquarters Plaza II
One Speedwell Avenue

Morristown, New Jersey 07960

Attorneys for Appellees

OPINION OF THE COURT

SEITZ, *Circuit Judge.*

The plaintiffs in this action appeal a district court order dismissing their complaint for failure to state a claim upon which relief may be granted. This court has jurisdiction under 28 U.S.C. §1291 (1982).

I.

Plaintiffs are twenty-three investors in a failed limited partnership. Defendant Fidelity Union Bank/First National State is the successor to Garden State National Bank, the institution involved in the events at issue here (both Fidelity Union Bank/First National State and Garden State National Bank will be referred to as "the Bank"). Defendant Gary Flaker was at all relevant times a vice president and loan officer of the Bank. Defendant Kevin Shanley was vice chairman of the Bank.

For present purposes, we must assume that the facts set forth in the complaint are true. *Wisniewski v. Johns-Manville Corp.*, 759 F.2d 271, 273 (3d Cir. 1985). These facts are as follows. In 1980 various individuals and entities organized the Continental Energy Associates IV limited partnership (Continental) to engage in oil and gas drilling. Plaintiffs allege that some or all of these organizers had preexisting debts to the Bank and could obtain the funds to repay these obligations only by selling interests in Continental to outside investors. Certain Continental organizers arranged with Shanley for the Bank to loan

money to persons who wished to invest in Continental. Shanley authorized the organizers to advise prospective investors of the terms on which the Bank would lend funds for investment in Continental and to solicit and process loan applications. In some instances, the Bank authorized the organizers to transmit loan documents from the Bank to investors and from investors to the Bank. Shanley directed Flaker to process loan applications from prospective investors in Continental.

The Continental organizers approached each of the plaintiffs to induce them to purchase limited partnership interests in Continental. To this end, the organizers made several material misrepresentations. They told the plaintiffs that the bank was financing Continental's oil and gas drilling program. They also stated that the Bank had examined the geological data concerning the proposed drilling program and had concluded that the program was a completely safe investment. The organizers further represented that the Bank would lend the entire purchase price of each investor's limited partnership interest, regardless of the investor's ability to repay the loan from his own funds, because the Bank was satisfied that the investors would be able to repay the purchase price in two to three years out of the profits realized and distributed by Continental. The complaint alleges that, in approaching plaintiffs and making these misrepresentations, the organizers acted as agents of the Bank.

The plaintiffs borrowed a total of \$2,310,000 from the Bank, in amounts ranging from \$60,000 to \$300,000. Most of the plaintiffs borrowed an amount equal to all or substantially all of the purchase price of their interests in Continental. The Bank granted the loans to plaintiffs without following its normal procedures for verifying the creditworthiness of loan applicants. This departure from standard practice was intended to assure the plaintiffs of

the soundness of the venture. At the time it made the loans, the Bank knew or should have known of the organizers' misrepresentations to the plaintiffs. Flaker assured several of the plaintiffs that the organizers' representations were true, when he knew or should have known that the statements were false.

The interests in Continental proved to be worthless. The plaintiffs subsequently commenced this action for damages against the Bank, Shanley, and Flaker. The complaint alleges violations of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§1961-1968 (1982 & Supp. III 1985), and various pendent claims under state law. The RICO count alleges, *inter alia*, that in furtherance of a scheme to defraud the plaintiffs, the defendants used, and caused the plaintiffs to use, the United States mails on two or more occasions, in violation of the federal mail fraud statute, 18 U.S.C. §1341 (1982). Mail fraud falls within RICO's definition of "racketeering activity." 18 U.S.C. §1961(1) (Supp. III 1985).

The district court granted the defendants' motion to dismiss the RICO claim. The court held that the acts of mail fraud alleged in the complaint did not amount to a "pattern" of racketeering activity, an essential element of a RICO claim, *see* 18 U.S.C. §§1961(5), 1962 (1982). The court employed a two-pronged definition of "pattern." Under this definition, racketeering activity constitutes a pattern only if it is in furtherance of (1) two or more unlawful schemes, or (2) a single, open-ended, ongoing scheme. The court found that the complaint alleged only a single scheme, a plan fraudulently to obtain loan applications from investors in Continental. The court also determined that the alleged scheme was not open-ended because it had fully attained its objective and posed no threat of further unlawful activity.

Having held that the plaintiffs failed to state a claim under RICO, the district court dismissed the remainder of the complaint for lack of subject-matter jurisdiction. This appeal followed.

II.

The sole question before us is whether the district court erred in holding that the plaintiffs' complaint failed to allege a "pattern of racketeering activity" as that term is used in RICO. Our review is plenary.

The RICO statute states that a "'pattern of racketeering activity' requires at least two acts of racketeering activity." 18 U.S.C. §1961(5) (1982). In *Sedima S.P.R.L. v. Imrex Co.*, 473 U.S. 479 (1985), the Supreme Court observed in dictum that although two acts of racketeering are necessary to form a pattern, they may not be sufficient. *Id.* at 496 n. 14. The Court continued:

The legislative history supports the view that two isolated acts of racketeering do not constitute a pattern. As the Senate Report explained: "The target of [RICO] is thus not sporadic activity. The infiltration of legitimate business normally requires more than one 'racketeering activity' and the threat of continuing activity to be effective. It is this factor of *continuity plus relationship* which combines to produce a pattern." S. Rep. No. 91-617, p. 158 (1969) (emphasis added).

Id.; *accord id.* at 527-28 (Powell, J., dissenting). The *Sedima* dictum has been widely viewed as a signal to the federal courts to fashion a limiting construction of RICO around the pattern requirement and the concepts of "continuity" and "relationship." The position of the district court in

this case that a pattern requires either two distinct schemes or a single ongoing scheme represents an attempt to constrain the reach of the statute along the lines suggested by *Sedima*.

In previous RICO cases this court has not had occasion to define the precise contours of the pattern requirement. *See Town of Kearny v. Hudson Meadows Urban Renewal Corp.*, No. 87-5044, slip op. at 11-12 (3d Cir. Sept. 25, 1987); *Petro-Tech, Inc. v. Western Co. of N. Am.*, 824 F. 2d 1349, 1354-55 (3d Cir. 1987); *United States v. Grayson*, 795 F. 2d 278, 289-90 (3d Cir. 1986), cert. denied, 107 S. Ct. 927 (1987); *Malley-Duff & Assocs. v. Crown Life Ins. Co.*, 792 F. 2d 341, 353 n. 20 (3d Cir. 1986), aff'd, 107 S. Ct. 2759 (1987). In those cases we assumed, without deciding, that a pattern requires not only two acts of racketeering but also two distinct unlawful schemes. In each instance, we concluded that the facts before us satisfied even this stringent standard. Those cases, however, also recognized that the existence of a RICO pattern does not turn on the abstract characterization of racketeering acts as "continuous" and "related" but rather on a combination of specific factors such as the number of unlawful acts, the length of time over which the acts were committed, the similarity of the acts, the number of victims, the number of perpetrators, and the character of the unlawful activity. *See Petro-Tech*, 824 F. 2d at 1355 (cases refusing to find a RICO pattern are "distinguishable from this case on the basis of the time period, number of victims, number of perpetrators and number of predicate acts at issue"); *see also Town of Kearny*, slip op. at 11; *Grayson*, 795 F. 2d at 290.

The complaint in this case arguably depicts an unlawful venture more modest than those involved in our earlier cases. Cf. *Town of Kearny*, slip op. at 12 (two separate schemes to bribe city officials); *Petro-Tech*, 824 F. 2d at 1355 (fraud involving services for eighty oil wells

performed pursuant to two contracts covering different time periods); *Grayson*, 795 F. 2d at 290 (seven racketeering acts, performed over a period of more than a year, involving manufacture, distribution, and sale of methamphetamine and phencyclidine); *Malley-Duff*, 792 F. 2d at 353 n. 20 (fraudulent termination of insurance agencies in several cities). Indeed, the plaintiffs concede that they have alleged only a single unlawful scheme.

Nevertheless, we believe the district court erred in concluding that the plaintiffs failed to allege a RICO pattern. Although the complaint states only that the defendants committed "two or more" acts of mail fraud in furtherance of their alleged scheme, it may fairly be inferred from the nature of the scheme that defendants engaged in considerably more than two such acts. The scheme was carried out by several individuals and two separate entities, Continental and the Bank. Most significantly, the scheme involved the repetition of similar misrepresentations to more than twenty investors. To refer to such conduct as a "pattern" of fraudulent activity certainly comports with the ordinary understanding of the term, and we believe that this conduct properly falls within the reach of the RICO statute.

In holding that the complaint alleges a pattern of racketeering activity, we reject the position that a RICO pattern must involve at least two distinct unlawful schemes. *See, e.g., Superior Oil Co. v. Fulmer*, 785 F. 2d 252 (8th Cir. 1986). We note two difficulties with this view. First, "scheme" is hardly a self-defining term, and it appears nowhere in the RICO statute. We prefer to confront the inevitable definitional problems in this context by interpreting the "pattern" language directly, rather than by introducing a new and perhaps more amorphous concept into the analysis. Second, even assuming one could adequately distinguish among multiple schemes, a

rule requiring two or more schemes would exempt from RICO liability defendants who engage in only a single unlawful scheme, however extensive and injurious. Such an outcome is plainly inconsistent with the purposes of the statute.

We also reject the view that racketeering acts committed pursuant to a single scheme can constitute a RICO pattern only if the scheme is potentially ongoing or open-ended. This requirement is ostensibly derived from the statement in RICO's legislative history, highlighted in *Sedima*, that a pattern must display "continuity" among the various acts of racketeering. See *Sedima*, 473 U.S. at 496 n. 14 (quoting S. Rep. No. 617, 91st Cong., 1st Sess. 158 (1969)). We do not believe, however, that the notion of continuity compels a requirement of "open-endedness." At the very least, such a requirement would produce anomalous results. This approach would allow a party to maintain a RICO claim if he brought suit before the unlawful scheme had attained its objective; in such a case the scheme would presumably be considered open-ended. This same interpretation, though, would deny a RICO cause of action in a case where the scheme had fully accomplished its goal. Yet it is the completed scheme that inflicts the greater harm and more strongly implicates the remedial purposes of RICO.

We read the legislative history's references to "continuity" as simply calling for an inquiry into the extent of the racketeering activity. Although temporal open-endedness may be one measure of extent, it is not the only one. We decline to adopt a verbal formula for determining when unlawful activity is sufficiently extensive to be "continuous." This determination necessarily depends on the circumstances of the particular case.

Finally, we fully appreciate the concern over civil

RICO's increasing use in attempts to reach "garden variety" business fraud and the potential utility of the pattern requirement as a means of curtailing this trend. The desire to limit the range of the statute, however, must be tempered by the insight that in some instances business-related fraud can constitute a pattern of racketeering activity under RICO. On the basis of the allegations contained in the complaint, we believe this is such an instance.

IV.

We will reverse the judgment of the district court dismissing plaintiffs' RICO claim and remand for proceedings consistent with this opinion. Because we hold that the district court erred in dismissing this federal claim, we also hold that the court erred in dismissing plaintiffs' pendent state claims for lack of subject-matter jurisdiction. Accordingly, we will order that plaintiffs' pendent claims be reinstated.

A True Copy:

Teste:

*Clerk of the United States Court of Appeals
for the Third Circuit*

APPENDIX Q

OPINION OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK IN KRANTZ V. SCHLESINGER, NO. CV-86-1637, SLIP OP. (E.D.N.Y., NOVEMBER 16, 1987)

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

CV-86-1637

MEMORANDUM AND ORDER

LARRY KRANTZ, ET AL.,
Plaintiffs,

-against-

RICHARD SCHLESINGER, ET AL.,
Defendants.

APPEARANCES:

Larry H. Krantz
Pro se and as Attorney for Plaintiffs
29-07A 159th Street
Flushing, New York 11358
By: Larry H. Krantz, Esq.
Attorney for Plaintiffs

Summit Rovins & Feldesman
445 Park Avenue
New York, New York 10022

By: Ronald E. DePetris, Esq.
Attorney for Defendants

WEINSTEIN, Ch. J.:

Plaintiffs, subscribers to an agreement to buy apartment units in the Mendocino Green Complex, brought suit against the sponsor of the offering plan to convert the complex to a condominium development. They allege violation of 18 U.S.C. §§1961-68 (RICO) predicated upon alleged commission of mail fraud incident to two schemes by defendants to abandon the plan. Fraud and breach of contract under state law are also alleged. The schemes to defraud were allegedly directed against plaintiffs and the New York State Attorney General.

Defendants made a motion to dismiss, and plaintiffs were given leave to amend the complaint. In March of this year, defendants' motion to dismiss the amended complaint was denied. Also denied was defendants' application for certification of an order allowing an interlocutory appeal.

Defendants now renew their motion to dismiss the amended complaint. Fed. R. Civ. P. 12(b), (h). For reasons stated below, plaintiffs' federal claim must be dismissed for failure to adequately plead the continuing criminal enterprise requirement of RICO, 18 U.S.C. §§1961(4), 1962, and for lack of subject matter jurisdiction.

I. FACTS

Plaintiffs' civil RICO claim arises from an agreement with defendants Richard Schlesinger, doing business as Wags Realty, a sole proprietorship; Quest-Co. Ltd., a corporation and licensed real estate broker; and Baldwin Townhouse Company, a general partnership including

Richard Schlesinger. Defendants are referred to collectively as the "sponsor" of the offering plan.

In March, 1985, plaintiffs executed an agreement with defendants to buy an apartment in the Mendocino Green Complex, which was then owned by Baldwin Townhouse. Quest-Co. Ltd. was the selling agent for the units. The purchase agreement contained the terms of the condominium offering plan. It provided for certain situations under which the plan could be abandoned, including the "...existence of a defect in title which cannot be cured except by litigation or otherwise at a cost to the sponsor of less than \$50,000...".

Later that month, the sponsor filed an amendment to the plan, declaring it effective. After having difficulty obtaining approval from the Nassau County Planning Commission for the subdivision of the complex into separate tax units, the sponsor submitted a form to the New York State Attorney General's office abandoning the plan. The stated reason for abandonment was the cost of compliance with subdivision requirements of the Nassau County Planning Commission.

In March, 1986, the Attorney General rescinded the sponsor's attempted abandonment, finding that the sponsor had failed to substantiate the basis for abandonment. Subsequent to the filing of the amended complaint in this action, the Attorney General conducted a more thorough investigation, finding that defendants' conduct constituted a fraud on the purchasers and the Attorney General.

The majority of aggrieved purchasers have settled with defendants, allowing the sponsor to convert the complex into a cooperative. *Annunziata v. Schlesinger*, No. 86-3511 (Sup. Ct., Nassau Cty., Sept. 16, 1986). Plaintiffs

have refused to participate in this settlement.

The amended complaint alleges that defendants, individually and collectively, are enterprises within the meaning of RICO, 18 U.S.C. §1961(4), and that they have knowingly and willfully participated in the affairs of these enterprises. The alleged pattern of racketeering activity consists of schemes to abandon the offering plan so that a new plan could be submitted later at a higher price, of defrauding prospective buyers, including plaintiffs, and of defrauding the Attorney General. The sponsor purportedly used the requirements imposed by the Nassau County Planning Commission as a way to rescind its legal obligations under the plan, misrepresenting, through fraudulent mailings, what compliance with the requirements would entail.

II. CONTINUING ENTERPRISE REQUIREMENT

In *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479 (1985), the Supreme Court held that a violation of 28 U.S.C. §1962(c) requires "(1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity." *Id.* at 46. In a footnote elaborating on the pattern element, the court emphasized the necessity of a continuing relationship. It wrote:

...the definition of a "pattern of racketeering activity" differs from the other provisions in §1961 in that it states that a pattern "requires at least two acts of racketeering activity" §1961(5) (emphasis added) ... As the Senate Report explained: ... The infiltration of legitimate business normally requires more than "one racketeering activity and the threat of continuing activity to be effective. It is this factor of continuity plus relationship which combines to produce a

pattern." (Senate Rep. No. 91-617, p. 158 (1969) (emphasis added).

Sedima, 473 U.S. at 496, n. 14.

Each circuit has since considered the question of standards for pleading a valid RICO claim, attempting to implement *Sedima*'s directive to create a standard for a pattern based on "continuity plus relationship." This has been difficult, in light of the fact that *Sedima* suggested that while narrowing the scope of RICO was the job of Congress, there are dangers in the divergence of RICO from its original intent due to the increasing breadth of predicate offenses. *Id.* at 500.

One circuit has held that if predicate acts are all committed in furtherance of a single scheme, there is insufficient continuity to meet the pattern requirement. *Superior Oil Co. v. Fulmer*, 785 F. 2d 252, 257 (8th Cir. 1986). In another the predicate acts do not need to occur in different criminal episodes or schemes. *Bank of America v. Touche Ross & Co.*, 782 F. 2d 966, 971 (11th Cir. 1986).

Several circuits have taken a middle ground. In *Morgan v. Bank of Waukegan*, 804 F. 2d 970, 975 (7th Cir. 1986), the court stresses that the pattern requirement is a standard, not a rule, holding that "... [r]elevant factors include the number and variety of predicate acts and the length of time over which they were committed, the number of victims, the presence of separate schemes and the occurrence of distinct injuries ..." *Id.* at 975-76. In *Morgan*, the court found that although the acts of mail fraud were distinct, some relating to separate foreclosure sales, and others relating to fraudulent statements made in connection with a loan transaction, they were ongoing over a period of nearly four years, thus satisfying the continuity and relationship aspects of the pattern

requirement. *Id.* at 976.

The Second Circuit requires continuity for both the pattern of racketeering and the enterprise itself. An enterprise with a single purpose, such as fraud, can provide the basis for a Section 1962(c) violation only if the purpose has no obvious terminating goal or date. *United States v. Ianniello*, 808 F. 2d 184, 191-92 (2d Cir. 1986). In *Ianniello*, the enterprise continually skimmed profits from bars and restaurants that it owned and operated in Manhattan. The court found a broad pattern of racketeering activity in the conduct of the enterprise affairs — including predicate acts of mail fraud, bankruptcy fraud, and tax evasion — which also supplied the continuity element, since the enterprise was a continuing operation. *Id.* at 190-91.

The continuing enterprise requirement was not satisfied, however, in *Beck v. Manufacturers Hanover Trust*, 820 F. 2d 46 (2d Cir. 1987), in which the plaintiff alleged a three phase conspiracy to sell United States collateral at an artificially low price, defrauding bond-holders, and depriving the government and people of Mexico of their share of the proceeds of the sale of the collateral. *Id.* at 49. Although the court found that the two related acts of mail and wire fraud satisfied the pleading requirement of racketeering activity, the amended complaint was held to be insufficient, since the enterprise had only one straightforward short-lived goal — the sale of the collateral at a reduced price, and it ceased functioning at the conclusion of the sale. *Id.* at 51. The court stated:

An enterprise is a group of persons associated together for a common purpose of engaging in a course of conduct ... proved by evidence of an ongoing organization (citations omitted) ... This circuit requires

that, under Section 1962(c), the enterprise be a continuing operation and that the [predicate] acts be related to the common purpose.

Beck, 820 F. 2d at 51, quoting *Ianniello*, 808 F. 2d at 191. See also *Albany Insurance Co. v. Esses and Shoe Tastics, Inc.*, ___ F. 2d ___, slip op. 5711 (2d Cir. Oct. 15, 1987) (dismissing a civil RICO claim even though the mail fraud and arson constituted a pattern, because the defendant's one obvious goal — inducing the plaintiff to pay a false insurance claim — did not constitute a continuing enterprise with regard to criminal activity).

III. LACK OF CONTINUING ENTERPRISE

Under the standard set forth in *Ianniello* and *Beck*, plaintiffs have adequately pleaded a pattern of racketeering activity. They have alleged multiple episodes of mail fraud, committed in a scheme to defraud plaintiffs and the Attorney General. The acts, even if they were only conducted from 1985, when the first reference to abandonment was made, until 1986, when the Attorney General rescinded the abandonment, were continuous enough over a period of time to establish a pattern of racketeering activity.

Plaintiffs' amended complaint is deficient, however, in its failure to sufficiently allege the continuity of the enterprise's criminal activity. Plaintiff alleges an enterprise — a unit involved with the commencement and abandonment of an offering plan — which defrauded plaintiffs and the Attorney General, and has ceased to function in terms of any criminal activity. The fact that it has ceased to function by operation of law due to the state court settlement is not relevant, since there is no allegation that absent this settlement, this enterprise was to

engage in ongoing criminal activity after the plan of abandonment.

The *Esses* court rejected the argument urged by plaintiffs that the requirement of continuity of criminal activity or purpose is not applicable where the enterprise is a legitimate business. *Esses* at 5711. *See also Mastercraft Industries v. Breining*, ___ F. Supp. ___ No. 86 Civ. 6384 (S.D.N.Y. July 28, 1987) (dismissing complaint alleging fraudulent failure to perform contractual obligations in connection with a real estate transaction for failure to meet the requirement of "continuity of criminal purpose," continuing enterprise element not satisfied merely because the defendant's lawful business is continuing).

IV. CONCLUSION

Plaintiffs' RICO claims are dismissed as to all defendants with prejudice.

At oral argument, the parties stipulated that all plaintiffs' state claims against all defendants except Schlesinger are dismissed on the merits. Plaintiffs will amend the complaint as to defendant Schlesinger and plead all state law claims against defendant Schlesinger. Jurisdiction will be based on a theory of diversity. Defendant Schlesinger retains the right to challenge the complaint on diversity and all other grounds. Plaintiffs agree that all claims against other defendants are dismissed with prejudice.

So ordered.

Dated: Brooklyn, New York
November 16, 1987

s/
Chief Judge, U.S.D.C.

